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REAL ESTATE OUTLOOK

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A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- On the basis of preliminary data, the Commerce Department reported that the annual rate of real GNP growth during the third quarter reached 2.5 percent, the same rate of advance recorded in the second quarter, and generally in line with expectations.
- The consumer price index rose by a slight 0.2 percent in September, after staying unchanged in August. For the first three quarters, the CPI has risen at a 4.4% annual rate.
- The 30-year government bond rate is expected to fall to 7.9% by the end of 1989, and average 7.6% in 1990. Mortgage interest rates are expected to hover around 9.75% through the end of 1989, before sliding lower in early 1990.
- Housing starts activity was dealt a setback in September, as total starts fell to an annual rate of 1.263 million units, 5.2 percent below the August rate of 1.332 million units, and 13.7 percent behind the September 1988 pace. Single-family starts retreated to an annual rate of 971 thousand units, 2.1 percent below the August rate of 992 thousand units, and 6.5 percent slower than the September 1988 annual rate of 1.039 million units.
- After two months of relatively strong activity, September sales of new single-family homes fell to an annual rate of 618 thousand units, down 14.0 percent from the August rate of 719 thousand units; and 10.6 percent below the September 1988 annual rate of 691 thousand units.
- Sales of existing single-family homes rose strongly in September to an annual rate of 3.63 million units, an increase of 4.3 percent from the revised August annual rate of 3.48 million units; and virtually unchanged from the September 1988 annual rate of 3.65 million units.

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BACK TO THE FUTURE
Economic Commentary

by
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"We are borrowing prosperity from the future"
"Whether the rate of growth in consumer debt will slow down is no longer the question;...it must slow down"

Sound familiar? These are refrains that are heard throughout the land on virtually a daily basis. Mounting debt--public and private government and consumer--has become a central fact of economic life. Yet, the statements entered above come from an analysis written in 1955, not 1989. We're citing them not to dismiss debt concerns as a problem, which we always have with us. Rather, it's to indicate that many of the origins of the debt of the Eighties--and more importantly, debt growth in the Nineties--are the same as those which generated worry in the Fifties.

In the decade and a half after World War II, the United States changed dramatically. The war had emptied rural America and swollen cities; the postwar population burst created suburban rings. And with the suburbs came investment in houses, roads, schools and hospitals. That rebuilding of an entire nation was accomplished by "nesting" households, those with heads between 25 and 44 years of age, whose time of life led them to create families, buy houses, cars and furniture, and fill up the maternity wards of the new hospital and classrooms of the new schools with their offspring. In doing this, they incurred debt in amounts unprecedented in U.S. history. In retrospect, I don't think we would view that accumulation as a negative behavior that should have been avoided at all costs. Rather, we view it as a process that built a strong economic machine.

Now we talk endlessly about the baby boom generation. (Q: In the year 2010 will we be watching a bunch of obnoxious retirees on "sixtysomething"?).

Yet, the proportion of American households headed by 25-44 year olds in 1985--43 percent--is unchanged from the figure for 1950. And while history may not be a circle, it certainly is a spiral, and we are seeing, from a consumer debt standpoint, a duplication of the Fifties.

Wait a minute! How can we possibly compare these live-for-the-moment Yuppies to the good solid family builders of thirty-five years ago? Because things change, and the current "nesting" generation is going through the same process in a different world. We see, in our mind's eye, a suburbia fixed in the Fifties--June Cleaver in her Levitt house kitchen, waiting for the boys to come home from school and Ward to catch the 5:08 from the city. Well, June is out working and neither she nor Ward will catch that train--or even the 6:08. And the boys are programmed and scheduled from school to computer lab to soccer practice.

It's a human tendency for ideas and conceptions to solidify early in adulthood. For most of us, the suburbs are as they were in the Fifties and Sixties. But now expectations are higher, life is busier and stress is more of a fact of life for most of the middle class. And the consumption and debt patterns of this generation recognize that, focussing as they do on convenience (two cars, restaurant meals) and substitution services (day care, lawn and garden maintenance) and time saving gratification (state-of-the-art electronics).

The debt run-up by the baby boomers represents the pursuit of the same ends as their parents, but in a far more complex world. Like their forbearers, the present generation will pay off these debts. We expect that consumer debt as a percent of income will peak early in the coming decade and decline dramatically through the turn of the century. This suggests a decline in interest rates that will dominate the Nineties.

If the private portion of our debt is understandable, the public portion carries lingering uncertainties. The great bulk of the investment we made in the Fifties needs renewal. The renewal of our public infrastructure--roads, bridges, tunnels, sewers--looms as one of the major challenges of the Nineties. Moreover, we face an opportunity this decade to renew our productive capital (both physical and human) and leapfrog our European and Asian competitors. In fact, population dynamics in the form of a shrinking labor pool suggest that this opportunity may become a necessity. Clearly, the Nineties must be a decade of public investment on a scale comparable to the Fifties.

Some of this can be accomplished within current budgetary limits. Clearly, Federal spending is in part wasteful and can be trimmed back; the survival of Mr. Gorbachev may give us the opening we need to redirect military spending to other uses. But if we are to renew our public physical capital, make the public investments we need in education and health, and allow private firms to adopt up-to-date production methods, we need to generate resources from either voluntary or forced saving. The behavior of the baby boom generation will seemingly accomplish the former. But we, as a people, must ultimately face the question of whether we value continued progress sufficiently to tax ourselves to pay for it.

The economic accomplishments of the Fifties fueled a marvelous economic engine. But we would no longer wish to live with the economic standards that seemed so lofty then. The Nineties can provide the same long term impetus but require some more complex thought and effort lest we fall back to those standards.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

On the basis of preliminary data, the Commerce Department reported that the annual rate of real GNP growth during the third quarter reached 2.5 percent, the same rate of advance recorded in the second quarter, and generally in line with expectations. The third quarter report suggests key sector weaknesses that will likely carry forward into the next quarter, reducing projections for fourth quarter GNP growth. However, the third quarter report does paint a picture of the economy attaining the "soft landing" scenario in 1989, sought by most analysts and policymakers. Concerns of a recession, while not erased, have been at least moved back a few quarters. Instead, the ups and downs of the dollar and the stock market, and efforts to anticipate the Fed's next policy move will continue to act as wildcards in the economic outlook. The most likely scenario is one of even slower real GNP growth beginning in the fourth quarter of 1989 and continuing through 1990, and characterized by small increases in unemployment, falling interest rates, and no recession.

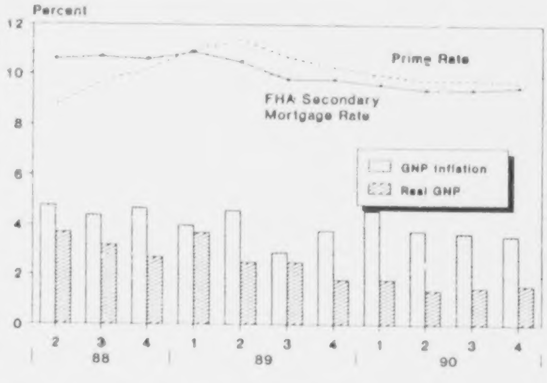
The Composition of 3rd Quarter GNP Growth

Signs of weakening in key components of the GNP report point toward this scenario of slower GNP growth beginning next quarter. For example, while consumer spending was up 5.8 percent in the third quarter compared to a modest 1.9 percent gain in the second, most of the third quarter advance was due to incentive-led car sales: durable spending rose at a 15.0 percent annual rate. But fourth quarter consumer spending will likely be down as the incentive plans typically borrow from future sales. In what was perhaps the biggest surprise of the GNP report, the external deficit, as measured by real net exports, deteriorated by nearly $23 billion, falling to a deficit of $74.1 billion. This component of the preliminary GNP report is particularly prone to revision, as the Commerce Department only has two months of data available when it makes this initial estimate. The tremendous drag on economic growth by the external sector was only partially offset by a surge in inventory investment. Yet, the higher than expected inventory build-up could mean slower growth in the next quarter as businesses turn to reducing their stocks in the face of slower consumer spending.

Growth in Personal Income & Spending Slow

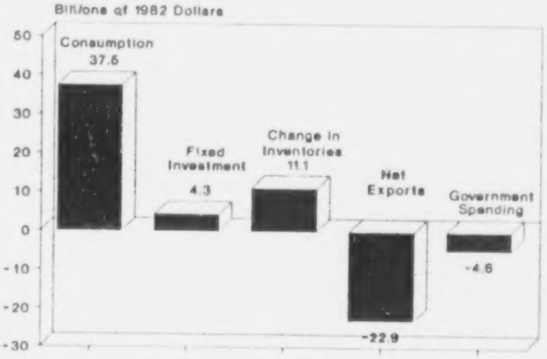
Evidence of weaker consumer spending emerged in the monthly data at the end of the third quarter: personal spending growth slowed to a modest 0.2 percent in September, reaching an annual rate of $3.526 trillion. Stronger personal spending patterns earlier in the third quarter had contributed a great deal to last quarter's advance in real GNP. The small September gain was the slimmest monthly advance in a year, and sets the stage for a markedly slower fourth quarter. Personal income rose by only 0.3 percent in September, but it would have advanced by 0.6 percent without Hurricane Hugo. The car purchases that drove personal spending during the summer are expected to leave a hole in spending patterns in the fourth quarter, at a time when personal income growth is easing: the expected result is a shy consumer.

GRAPH 1: THE ECONOMIC OUTLOOK



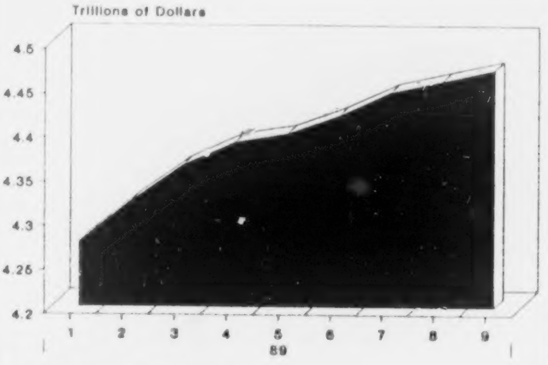
Source: Bureau of Economic Analysis; E NAR estimates

GRAPH 2: COMPOSITION OF GNP GROWTH



Source: Bureau of Economic Analysis

GRAPH 3: PERSONAL INCOME GROWTH SLOWS



Source: Department of Commerce

Source: Department of Commerce

Does "Soft Landing" Mean Softer Inflation?

The most recent information on consumer price inflation might suggest it does, but other indicators point to a core rate of inflation of about 4 to 4.5 percent. The consumer price index rose by a slight 0.2 percent in September, after staying unchanged in August. Month-to-month changes can be misleading, so it pays to look at the CPI advances over the course of 1989. For the first three quarters, the CPI has risen at a 4.4% annual rate. The annual rate of change in the CPI has been 5.4% in the first quarter, 6.4% in the second, and 2.4% in the third. Most of the recent easing in inflation has come from falling energy prices and milder increases in food prices. However, wages and salaries have been rising at a faster rate than the overall CPI number suggests. The Labor Department reports that wages and salaries, as measured in its employment cost index, rose by 1.6 percent in the third quarter, and are up 4.6 percent for the 12 months ending in September, compared to a 3.9 percent increase for the previous 12 months. This suggests that inflationary pressures are still bubbling under the temporary calm brought on by lower energy prices.

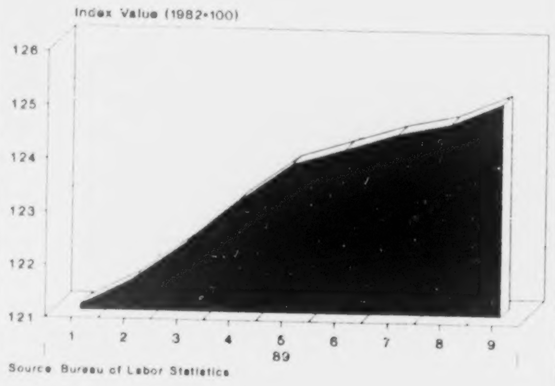
The Stock Plunge

It was scarier than any Friday the 13th imaginable: the Dow dropped 190 points in the last 90 minutes of trading and sent financial market players home for a nervous weekend full of frightening Monday morning scenarios. But heavy buying by bargain hunters helped to quickly restore much of Friday's losses midway through the following week. Apparently, an announcement by the lead banks in the UAL loan syndication that the deal would not proceed, led to fears that banks had become more cautious in their approach to LBO's; this in turn was seen to threaten many rumored deals. A correction for stocks of rumored takeover targets might not have been so damaging in its own right: many of these stocks appeared to be tremendously overvalued. However, the collapse of the takeover stocks pulled down the "good" stocks as well, due to program trading. The stocks not linked to takeovers rebounded strongly on Monday, but prices of many takeover stocks remained depressed. This plunge is different from October 1987, in that it is not expected to have any direct consequences to real GNP growth because stocks are not generally believed to be overvalued today. However, it might prompt the Fed into easing rates again.

Interest Rates Should Continue to Ease

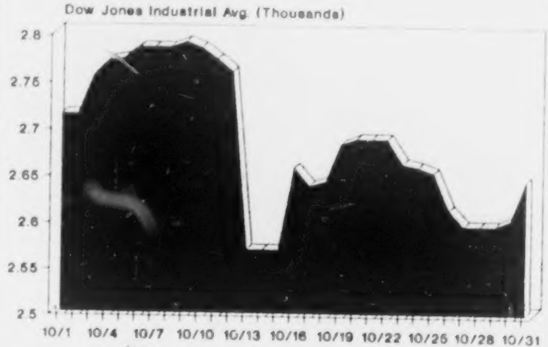
The Monday following the market plunge, the Fed pumped liquidity into the markets; less so than in October 1987, but enough to push the federal funds rate to as low as 8.5% during that week. After the market recovered, the Fed let the funds rate rise to a trading range of between 8.5% and 8.75%. As more data emerges to confirm a sluggish economy in the fourth quarter, the Fed will likely allow the federal funds rate to drift lower in the current quarter, and perhaps into the first half of 1990. The 30-year government bond rate is expected to fall to 7.9% by the end of 1989, and average 7.6% in 1990. Mortgage interest rates are expected to hover around 9.75% through the end of 1989, before sliding lower in early 1990.

GRAPH 4: HAS INFLATION REALLY SLOWED?



Source: Bureau of Labor Statistics

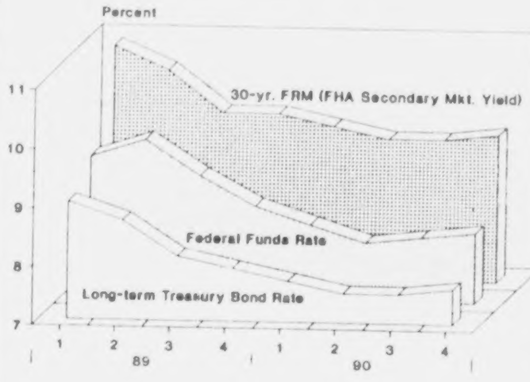
GRAPH 5: RUMORS RISE, STOCKS FALL



(Flat segments are non-trading days)

Source: The Wall Street Journal

GRAPH 6: INTEREST RATE OUTLOOK



Source: Federal Reserve, NAR Estimates

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

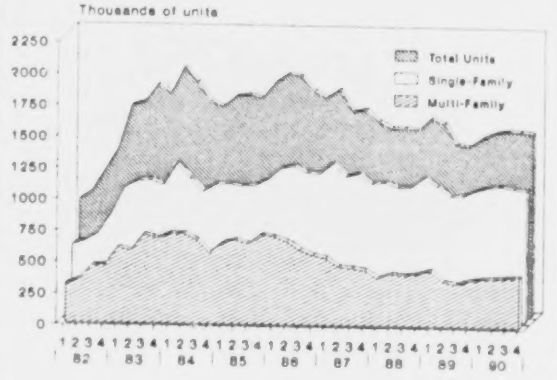
	Total	S-F	2-4	5 and up
Sep 1989	1263	971	51	241
Aug 1989	1332	992	53	287
Jul 1989	1420	1026	57	337
Jun 1989	1406	972	55	379
May 1989	1308	977	42	289
Sep 1988	1463	1039	62	362
Sep 1989 Changes From (%):				
Aug 1989	-5.2	-2.1	-3.8	-16.0
Sep 1988	-13.7	-6.5	-17.7	-33.4

REGIONAL DATA

	Northeast	Midwest	South	West
Sep 1989	170	243	477	373
Aug 1989	145	236	565	386
Jul 1989	189	274	531	426
Jun 1989	168	242	552	444
May 1989	176	244	513	375
Sep 1988	206	258	576	423
Sep 1989 Changes From (%):				
Aug 1989	17.2	3.0	-15.6	-3.4
Sep 1988	-17.5	-5.8	-17.2	-11.8

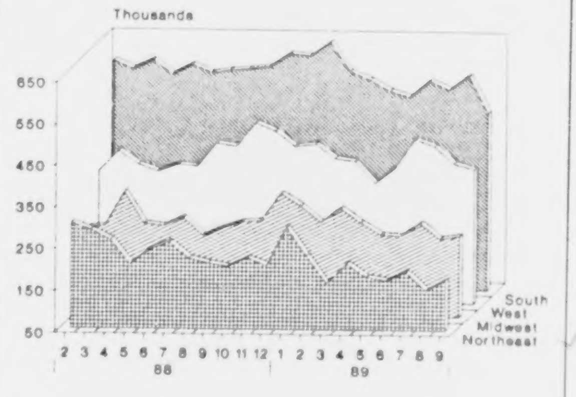
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Housing starts activity was dealt a setback in September, as total starts fell to an annual rate of 1.263 million units, 5.2 percent below the August rate of 1.332 million units, and 13.7 percent behind the September 1988 pace. The last two monthly declines have brought housing starts activity to its slowest pace in seven years. Single-family starts retreated to an annual rate of 971 thousand units, 2.1 percent below the August rate of 992 thousand units, and 6.5 percent slower than the September 1988 annual rate of 1.039 million units. Starts of structures containing 2-4 units declined 3.8 percent in September to an annual rate of 51 thousand units. Multi-family starts of structures containing 5 or more units declined 16 percent in September to an annual rate of 241 thousand units, and 33.4 percent below the September 1988 annual rate of 362 thousand units.

By region, the pace of starts activity was up 17.2 percent in the Northeast to an annual rate of 170 thousand units in September, but remained 17.5 percent below the year ago rate. Starts also rose in the Midwest, where they were up 3.0 percent to an annual rate of 243 thousand units, but were down 5.8 percent from their year ago pace. Activity slowed sharply in the South, where starts fell 15.6 percent to an annual rate of 477 thousand units, and were 17.2 percent below the September 1988 annual rate. Starts were down in the West as well, where they fell 3.4 percent to an annual rate of 373 thousand units, a rate 11.8 percent slower than that experienced in September 1988.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Sep	*1989*	*618*	*Feb*	*1989*	*621*
Aug	*1989*	*719*	*Jan*	*1989*	*700*
Jul	*1989*	*742*	*Dec*	*1988*	*669*
Jun	*1989*	*647*	*Nov*	*1988*	*650*
May	*1989*	*653*	*Oct*	*1988*	*718*
Apr	*1989*	*607*	*Sep*	*1988*	*691*
Mar	*1989*	*555*			

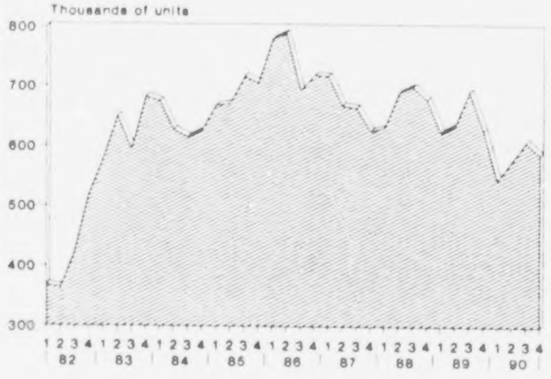
Sep 1989 Changes From:			*Annual Totals:*	
Aug	*1989*	*-14.0*	*1987*	*671*
Sep	*1988*	*-10.6*	*1988*	*676*

REGIONAL DATA

		Northeast	*Midwest*	*South*	*West*
Sep	*1989*	*58*	*96*	*252*	*211*
Aug	*1989*	*90*	*96*	*299*	*234*
Jul	*1989*	*101*	*127*	*284*	*230*
Jun	*1989*	*73*	*99*	*259*	*215*
May	*1989*	*89*	*99*	*271*	*195*
Apr	*1989*	*82*	*99*	*244*	*182*
Sep	*1988*	*86*	*99*	*261*	*245*
	1988	*102*	*97*	*276*	*202*
	1987	*117*	*97*	*271*	*186*
Sep 1989 Changes From:					
Aug	*1989*	*-35.6*	*0.0*	*-15.7*	*-9.8*
Sep	*1988*	*-32.6*	*-3.0*	*-3.4*	*-13.9*

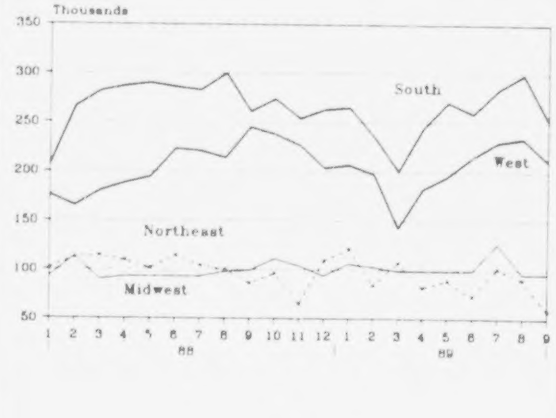
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

After two months of relatively strong activity, September sales of new single-family homes fell to an annual rate of 618 thousand units, down 14.0 percent from the August annual rate of 719 thousand units; and 10.6 percent below the September 1988 annual rate of 691 thousand units. New home sales estimates are often prone to large monthly swings, and the revisions of these statistics can also be substantial. In fact, the August 1989 report on new home sales originally pegged the annual rate of sales during the month at 755 thousand units. The September report revised down the original August estimate to an annual rate of 719 thousand units. Through the first three quarters of 1989, new single-family home sales have averaged an annual rate of 651 thousand units.

By region, sales of new homes were unchanged in the Midwest (at an annual rate of 96 thousand units), but slowed in each of the other three regions. The Northeast region suffered the largest decline, as new home sales fell 35.6 percent to an annual rate of 58 thousand units; the sales pace was also down 32.6 percent from its September 1988 annual rate of 86 thousand units. Sales in the South retreated to an annual rate of 252 thousand units, down 15.7 percent from August, and 3.4 percent slower than the September 1988 annual rate. New home sales in the West region slipped 9.8 percent to an annual rate of 234 thousand units, and were 13.9 percent below the 245 thousand unit sales pace of September 1988.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Sep	1989	3630	Feb	1989	3480
Aug	1989	3480	Jan	1989	3550
Jul	1989	3330	Dec	1988	3920
Jun	1989	3360	Nov	1988	3710
May	1989	3210	Oct	1988	3680
Apr	1989	3400	Sep	1988	3650
Mar	1989	3400			

Sep 1989 Changes From (%):		Annual Totals:	
Aug 1989	4.3	1988	3594
Sep 1988	-0.5	1987	3526

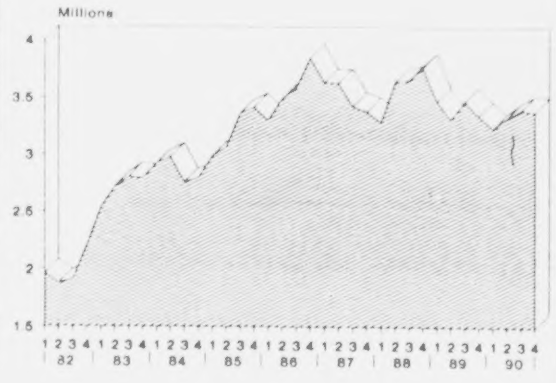
REGIONAL DATA

	Northeast	Midwest	South	West
Sep 1989	590	990	1400	620
Aug 1989	590	980	1350	550
Jul 1989	550	910	1300	570
Jun 1989	510	960	1280	600
May 1989	610	810	1230	580
Apr 1989	610	890	1280	620
Sep 1988	650	910	1390	700
1988	673	929	1350	642
1987	685	959	1282	600

Sep 1989 Changes From (%):				
Aug 1989	0.0	1.0	3.7	12.7
Sep 1988	-9.2	8.8	0.7	-11.4

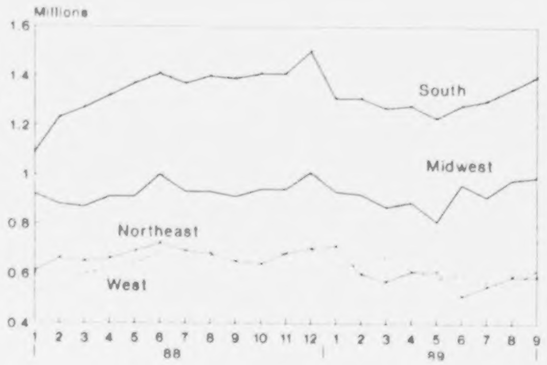
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

Sales of existing single-family homes rose strongly in September to an annual rate of 3.63 million units, an increase of 4.3 percent from the revised August annual rate of 3.48 million units; and virtually unchanged from the September 1988 annual rate of 3.65 million units. The September 1989 rate was the fastest monthly rate for existing single-family home sales since the 3.92 million unit rate of December 1988. Since up to 70 percent of the volume reported in this sales series can come from local real estate boards that report sales based on closing (rather than contract) dates, much of the strength in the September rate is likely from early summer contracts. Attractive mortgage rates continuing into the final quarter of 1989 is expected to sustain the pace of existing home sales at an annual rate of almost 3.4 million units, before slowing in the first half of 1990 to an average annual rate of 3.29 million units.

By region, the pace of existing home sales remained unchanged in the Northeast (at an annual rate of 590 thousand units), and rose in each of the other regions. September sales in the West rose 12.7 percent to an annual rate of 620 thousand units, but were 11.4 percent below their year ago pace. Sales in the South rose 3.7 percent in September to an annual rate of 1.4 million units, 0.7 percent above the September 1988 rate. In the Midwest, sales rose a scant 1.0 percent to an annual rate of 990 thousand units, but were reported to be 8.8 percent higher than their September 1988 annual rate.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

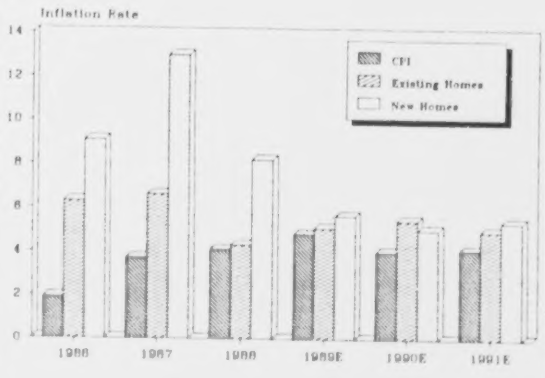
	Median		Average	
	Existing	*New*	*Existing*	*New*
Sep 1989	*93,400*	*122,500*	*117,400*	*154,400*
Aug 1989	*94,800*	*122,200*	*120,800*	*161,300*
Jul 1989	*96,700*	*117,000*	*122,100*	*141,800*
Jun 1989	*93,400*	*122,800*	*118,800*	*153,600*
May 1989	*92,600*	*119,000*	*118,000*	*145,100*
Sep 1988	*88,500*	*116,600*	*112,600*	*142,700*
1988	*89,300*	*112,500*	*112,800*	*138,300*
1987	*85,600*	*104,500*	*106,300*	*127,200*
Sep 1989 Changes From (%):				
Aug 1989	*-1.5*	*0.2*	*-2.8*	*-4.3*
Sep 1988	*5.5*	*5.1*	*4.3*	*8.2*

REGIONAL DATA

	Northeast	*Midwest*	*South*	*West*
Sep 1989	*144,800*	*71,800*	*84,200*	*144,300*
Aug 1989	*149,000*	*71,900*	*86,100*	*147,500*
Jul 1989	*147,100*	*73,400*	*87,200*	*146,500*
Jun 1989	*149,900*	*72,000*	*85,000*	*134,500*
May 1989	*143,800*	*70,300*	*84,100*	*142,300*
Sep 1988	*141,500*	*67,500*	*81,400*	*128,300*
1988	*143,000*	*68,400*	*82,200*	*124,900*
1987	*133,300*	*66,000*	*80,400*	*113,200*
Sep 1989 Changes From (%):				
Aug 1989	*-2.8*	*-0.1*	*-2.2*	*-2.2*
Sep 1988	*2.3*	*6.4*	*3.4*	*12.5*

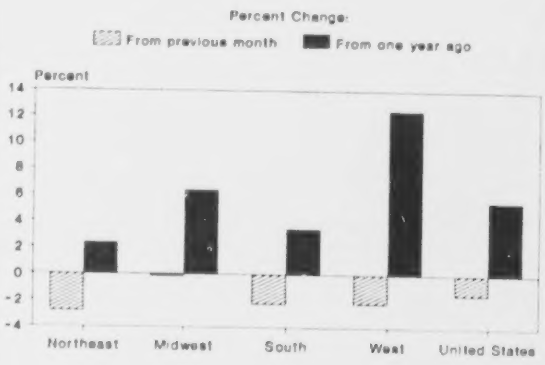
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

Despite the faster rate of existing single-family home sales, the median price of an existing home fell to $93,400 in September, 1.5 percent below the August median price of $94,800. However, over the past 12 months, the median price of an existing single-family home rose by 5.5 percent from the $88,500 median price of September 1988. All regions reported a decline in the median price, though the median price for the Midwest fell only $100 to $71,800, or 0.1 percent. In the Northeast, the median price fell 2.8 percent to $144,800, but was 2.3 percent higher than the September 1988 median price. In the South, the median price fell 2.2 percent to $84,200, but remained 3.4 percent above its year ago mark. In the West, the median price fell 2.2 percent to $144,300, but was up by 12.5 percent from its September 1988 mark.

The median price of a new single-family home rose by 0.2 percent in September to $122,500. This median price was 5.1 percent higher than the September 1988 median price of $116,600. The average price of a new single-family home fell 4.3 percent in September to $154,400, but was 8.2 percent higher than the September 1988 median price of $142,700.

Sean A. Burns
Director of Forecasting

FRMs, ARMs, GPMs, AND THE COST OF HOUSING - A CASHFLOW ANALYSIS

INTRODUCTION

During the last decade a vast array of different mortgage loans have reached the market. Although homebuyers now have many more mortgage options, they are also having a difficult time choosing among these loan alternatives. The choice, however, is important as it will impact directly on the cost of housing.

The objectives of this article are (1) to describe the characteristics of the most commonly used mortgages, (2) to discuss which type of mortgage instrument is best suited for certain types of households and, (3) to show how the choice of loan product will affect the costs of home ownership under different economic scenarios.

DESCRIPTION OF LOAN ALTERNATIVES AND STUDY ASSUMPTIONS

In this article, three of the most popular types of residential loans are examined -- the standard fixed rate, level payment mortgage (FRM), the adjustable rate mortgage (ARM), and the graduated payment mortgage (GPM).

The FRM serves as a benchmark against which to compare the other loan options. For the level payment, fixed rate loan we use a 10 percent mortgage interest rate. The increasing popularity of the ARM can be attributed to a number of factors, including the severe inflation encountered in the late 1970s and early 1980s and statutory and regulatory changes that have made lender cost of funds more variable. In the new environment of increased interest rate volatility, lenders have grown reluctant to lend at fixed rates for relatively long periods of time. Rates on ARMs are adjusted up or down based upon changes in financial indices. The two most common indices are based upon the one year Treasury Bill rate and the Federal Home Loan Bank Board's Cost of Funds Index. For the adjustable rate mortgage loan examples we assume an initial interest of 8.75 percent, 125 basis points below the FRM rate. The ARM in this example is structured with annual payment adjustments, with the interest rate indexed to the one year Treasury Bill rate. The ARM loan has a 2 percent annual interest rate cap and a life of the loan cap of 5 percentage points. In the worst case scenario, mortgage interest rates are assumed to rise continuously throughout the 5 year period, exceeding the annual 2 percent cap each year. Consequently, we adjust the interest rate by 2 percent for the first two years and 1 percent in year three, thereby reaching the maximum rate allowed under the life of the loan cap of 13.75 percent. The second scenario assumes the interest rate increases 1 percent a year, while the last case uses historical data to illustrate the effects of declining rates.

The GPM illustrated in this article is a fixed rate loan, also at 10 percent, which provides for a 7.5 percent per annum increase in loan payments for 5 years, after which time the payments remain constant for the remainder of the loan's term. The objective of the GPM is to provide for a series of mortgage payments that are lower in early years of the loan than would be the case with a standard mortgage loan. Because the initial payments in the first four years of the loan are not large enough to cover all the interest due, no amortization of principal occurs. The unpaid interest accrues and is added to the loan balance. This "negative amortization" continues, increasing the outstanding balance of the loan, until monthly loan payments rise above the periodic interest due on the loan, after which time the loan balance begins to decline, being fully amortized over the remaining term of the GPM.

In order to account for the time value of money, we use discounted cashflow analysis to compare the costs of these financing options. The cashflows associated with homeownership can be conveniently organized into three categories or phases. In the initial phase, we have the one-time costs of the closing and the downpayment. In the second, or operating phase, there is debt service, property taxes, maintenance expenses and tax savings. The tax savings results from the deduction of property taxes and mortgage interest in the computation of the homeowner's taxable income, which reduces his federal income taxes. In the terminal stage, we have the net proceeds from sale, which is equal to the selling price for the house net of the commission and selling costs less the outstanding balance of the mortgage. We assume any gains from sale realized by the homeowner are rolled over into the purchase of a new home, thereby deferring any tax on the gain.

Tables 1 through 4 display the cashflows associated with the purchase of a home in 1989 using the different mortgage instruments In the examples used here, the home price is $92,000, the downpayment is 20.50 percent, and closing costs are 5 percent. Property taxes and maintenance costs are calculated as 1.2 percent and 1.0 percent of the current market value of the home, which is assumed to increase at an average annual rate of 4.7 percent. The commission is 6 percent of the selling price which is projected to be $115,750 after 5 years, which translates into a 4.7 percent average annual rate of appreciation. All the above numbers are based upon a national housing and interest rate data obtained from selected issues of the Federal Reserve Bulletin and the July 1989 issue of National Association of Realtors®'s Home Sale Report.

To keep the calculations manageable, we assume the home is sold after 5 years. Even if not true for many homeowners, 5 years is a good planning horizon for these types of financial comparisons. We also assume the homeowner is in the 28 percent marginal tax bracket.

Last, the discount rate chosen for the current examples is 8.25 percent, the approximate yield on 5 year Treasury Notes, and a reasonable approximation of a typical homeowner's opportunity cost of capital. For the historical comparison, one year Treasury Bill rates are used since they represented the best, default-free return for the small investor during the period chosen, which was 1980 through 1985. During this period, the T-Bill rate ranged from a high of 13.14 percent to a low of 8.08 percent.

COMPARISON OF THE INSTRUMENTS

A comparison of the three types of loan alternatives displayed in the first four tables reveals that, in terms of cost, the FRM proved to be the least costly financing arrangement. The total after tax discounted cost of housing for the five year period was $27,822. Not surprisingly, given our assumptions, the ARM proved to be the most expensive, with the worst case scenario costing the homeowner $31,384, over $3,500 more than the FRM, even after discounting the much higher debt service in the later years of the ARM. Calculating the worst case scenario allows homebuyers to determine whether they can afford the maximum monthly and annual cash outflows that could result should they finance their home purchase with an ARM.

ARMs are not always more expensive than fixed rate loans. As Tables 5 and 6 indicate, had the current type of ARM been in place in 1980, it would have been actually less costly than a fixed rate mortgage. If we were to extend the homeowner's tenure to 8 years, to the end of 1987, the ARM would have proven significantly less expensive as interest rate fell almost 650 basis points during this time period.

The GPM proved to be an interesting case. Although the total cost proved to be nominally a bit more expensive ($200) then the fixed rate loan, with the GPM the homeowner has the benefit of much lower debt service payments during the early years of the loan. The smaller debt service not only increases budgetary flexibility but, for homeowners who have the opportunity of investing the payment differentials, the GPM can easily be the least costly loan alternative.

The other aspect of the GPM that warrants attention is the tax treatment of negative amortization. The difference between the interest due and the actual mortgage payment (col. 4 minus col. 3) is unpaid interest which is compounded forward and added to the loan balance. It can be seen from Table 4 that the balance increases for the first four years and then begins to decline once the mortgage payment exceeds the interest due on the loan. The difference between the outstanding loan balance and the initial loan amount reflects total accrued interest over the 5 year period and can be taken as a tax deduction in the year of sale.

Beside cost considerations, there are many other factors a home buyer should consider when deciding on how to finance the acquisition of a home. For conservative households, the FRM may be the most appropriate instrument because payments are constant over the life of the loan, thereby making budget planning easier. Such borrowers are also spared the burden of increasing mortgage payments should interest rates rise in the future. In addition to the fixed payment, the borrower can start to build equity immediately. The payment pattern of the GPM may be best suited for young, upwardly mobile, first time homeowners who may not be able to qualify for or afford the higher payments of a FRM.

The initial interest rate on an ARM is normally lower than on a fixed rate loan. This lower rate makes the ARM attractive to buyers who might otherwise not qualify for a FRM. They can also prove less costly should interest rates remain relatively stable or decline during their tenure of ownership.

With respect to this last point, the choice of index can prove to be an important decision parameter. Some indices, such as the T-Bill rate adjust quickly to changing economic conditions. During periods of falling interest rates, loan payments will fall more quickly and by larger amounts for ARMs indexed to the T-Bill rate, then for ARMs based on the much slower adjusting and less volatile cost of funds index. If the borrower's principal concern is rising future loan payments, the Federal Home Loan Bank Board's Cost of Funds Index might be the better choice of index.

When adjustable rates were first developed, many of the loans offered very low initial interest rate, often referred to as "teaser rates." In some cases, these rates were far below prevailing FRM mortgage rates, and were used as a method of qualifying marginal homebuyers. The danger with teaser rate is that payment shock and default may occur when the rate and payments are adjusted upward on the first anniversary of the loan. The use of teaser rates also makes it difficult to compare the true costs of alternative ARM instruments. Some predictability can be built into the loan by including provisions for caps. These caps, which are now common to most ARMs, offer protection to the borrower by limiting the size of future payment increases, thereby minimizing payment shock, and thus default.

CONCLUSION

In summary, the consumer has to consider many different factors when determining how best to finance a home purchase. These factors include the household's current and expected future income, anticipated inflation during their tenure of ownership, and the investment opportunities available to each homeowner. Using the type of analysis illustrated in this article, homebuyers can find the mortgage loan best tailored to their needs.

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Table 1
Current Cost of Housing
30 YEARS FIXED-RATE MORTGAGE

MEDIAN PRICE OF EXISTING HOUSE: $92,000 (1989)
HOUSE APPRECIATION RATE: 4.7%
DOWNPAYMENT: 20.50%
MAINTENANCE EXPENSES: 1.00%

TAX RATE: 28%
PROPERTY TAX: 1.20%

CLOSING COST: 5.00%
SELLING COST: 6.00%

Year	Property Taxes (1)	Maintenance Expenses (2)	Mortgage Payment (3)	Interest (4)	Mortgage Balance (5)	Annual Cash Outflow (6) = (1 + 2 + 3)	Tax Savings (7) = (1 + 4) Tax Rate	After Tax Cashflow (8) = (6-7)	Discount Rate (9)	Annual Discounted Cost (10)
1	1104.00	920.00	7758.64	7314.00	72695.36	9782.64	2357.04	7425.60	8.25%	6859.67
2	1155.85	963.20	7758.64	7269.54	72206.26	9877.69	2359.11	7518.58	8.25%	6416.23
3	1210.13	1008.44	7758.64	7220.63	71668.25	9977.20	2360.61	7616.59	8.25%	6004.50
4	1266.96	1055.80	7758.64	7166.83	71076.44	10081.39	2361.46	7719.93	8.25%	5622.14
5	1326.45	1105.38	7758.64	7107.64	70425.45	10190.47	2361.55	7828.92	8.25%	5266.99
										30169.53

Total Net Discounted Cost = $27822.6

Table 2
Current Cost of Housing
30 YEARS ADJUSTABLE-RATE MORTGAGE (THE "WORST" CASE)

Year	Property Taxes (1)	Maintenance Expenses (2)	Mortgage Payment (3)	Interest (4)	Mortgage Balance (5)	Annual Cash Outflow (6) = (1 + 2 + 3)	Tax Savings (7) = (1 + 4) Tax Rate	After Tax Cashflow (8) = (6-7)	Discount Rate (9)	Annual Discounted Cost (10)
1	1104.00	920.00	6961.90	6399.75	72577.85	8985.90	2101.05	6884.85	8.25%	6360.14
2	1155.85	963.20	8228.04	7802.12	72151.93	10347.09	2508.23	7838.86	8.25%	6689.55
3	1210.13	1008.44	9530.39	9199.37	71820.92	11748.95	2914.66	8834.29	8.25%	6964.47
4	1266.96	1055.80	10189.77	9875.38	71506.52	12512.52	3119.85	9392.67	8.25%	6840.34
5	1326.45	1105.38	10189.77	9832.15	71148.90	12621.60	3124.41	9497.20	8.25%	6389.34
										33243.8

Total Net Discounted Cost = $31383.67

Table 3
Current Cost of Housing
30 YEARS ADJUSTABLE-RATE MORTGAGE (THE "BAD" CASE)

Year	Property Taxes (1)	Maintenance Expenses (2)	Mortgage Payment (3)	Interest (4)	Mortgage Balance (5)	Annual Cash Outflow (6) = (1 + 2 + 3)	Tax Savings (7) = (1 + 4) Tax Rate	After Tax Cashflow (8) = (6-7)	Discount Rate (9)	Annual Discounted Cost (10)
1	1104.00	920.00	6961.90	6399.75	72577.85	8985.90	2101.05	6884.85	8.25%	6360.14
2	1155.85	963.20	7587.26	7076.34	72066.93	9706.31	2305.01	7401.30	8.25%	6316.15
3	1210.13	1008.44	8218.35	7747.20	71595.78	10436.91	2508.05	7928.86	8.25%	6250.68
4	1266.96	1055.80	8853.50	8412.50	71154.79	11176.25	2710.25	8466.00	8.25%	6165.48
5	1326.45	1105.38	9491.31	9072.24	70735.71	11923.15	2911.63	9011.51	8.25%	6062.59
										31155.03

Total Net Discounted Cost = $29016.88

Table 4
Current Cost of Housing
30 YEARS GRADUATED PAYMENT MORTGAGE

Year	Property Taxes (1)	Maintenance Expenses (2)	Mortgage Payment (3)	Interest (4)	Mortgage Balance (5)	Annual Cash Outflow (6) = (1 + 2 + 3)	Tax Savings (7) = (1 + 4) Tax Rate	After Tax Cashflow (8) = (6-7)	Discount Rate (9)	Annual Discounted Cost (10)
1	1104.00	920.00	5854.08	7266.00	74668.73	7878.08	1948.26	5929.82	8.25%	5477.89
2	1155.85	963.20	6293.16	7466.88	75897.77	8412.21	2085.72	6326.49	8.25%	5398.92
3	1210.13	1008.44	6765.12	7588.80	76761.28	8983.69	2233.07	6750.62	8.25%	5321.82
4	1266.96	1055.80	7272.48	7676.16	77183.99	9595.24	2391.04	7204.20	8.25%	5246.55
5	1326.45	1105.38	7817.88	7705.47	77071.58	10249.71	2528.94	7720.77	8.25%	5194.23
										26639.41

Total Net Discounted Cost = $28023.19

Table 5
Historical Cost of Housing
30 YEARS FIXED-RATE MORTGAGE

MEDIAN PRICE OF EXISTING HOUSE: $61,450 (1980)
HOUSE APPRECIATION RATE: 4.7%
DOWNPAYMENT: 20.50% TAX RATE: 28% CLOSING COST: 5.00%
MAINTENANCE EXPENSES: 1.00% PROPERTY TAX: 1.20% SELLING COST: 6.00%

Year	Property Taxes (1)	Maintenance Expenses (2)	Mortgage Payment (3)	Interest (4)	Mortgage Balance (5)	Annual Cash Outflow (6) = (1 + 2 + 3)	Tax Savings (7) = (1 + 4) Tax Rate	After Tax Cashflow (8) = (6-7)	Discount Rate (9)	Annual Discounted Cost (10)
1	737.40	614.50	6953.24	6814.96	48714.47	8305.14	2114.66	6190.48	10.89%	5582.54
2	772.03	643.36	6953.24	6795.67	48556.90	8368.63	2118.96	6249.67	13.14%	4882.30
3	808.29	673.57	6953.24	6773.69	48377.35	8435.09	2122.95	6312.14	11.07%	4606.66
4	846.24	705.20	6953.24	6748.64	48172.75	8504.68	2126.57	6378.12	8.80%	4551.73
5	885.98	738.32	6953.24	6720.10	47939.62	8577.54	2129.70	6447.84	9.92%	4018.19
										23641.43

Total Net Discounted Cost = $23904.20

Table 6
Historical Cost of Housing
30 YEARS ADJUSTABLE-RATE MORTGAGE

Year	Property Taxes (1)	Maintenance Expenses (2)	Mortgage Payment (3)	Interest (4)	Mortgage Balance (5)	Annual Cash Outflow (6) = (1 + 2 + 3)	Tax Savings (7) = (1 + 4) Tax Rate	After Tax Cashflow (8) = (6-7)	Discount Rate (9)	Annual Discounted Cost (10)
1	737.40	614.50	6467.36	6297.12	48682.51	7819.26	1969.67	5849.59	10.89%	5275.13
2	772.03	643.36	7380.62	7248.83	48550.71	8796.01	2245.84	6550.17	13.14%	5117.06
3	808.29	673.57	6555.91	6345.58	48340.38	8037.77	2003.08	6034.68	11.07%	4404.17
4	846.24	705.20	5570.14	5220.76	47991.00	7121.58	1698.76	5422.82	8.80%	3869.99
5	885.98	738.32	6043.91	5720.53	47667.62	7668.22	1849.82	5818.39	9.92%	3625.93
										22292.28

Total Net Discounted Cost = $22386.32

Sources for Tables 1 through 6: National Association of Realtors® Forecasting and Policy Analysis Division Estimates

DEMOGRAPHIC TRENDS INFLUENCING SINGLE-HEADED HOUSEHOLDS

The strong growth in the total number of households as experienced between 1970 and 1987 is expected to continue into the mid-1990s as the low end of the baby boom cohort reaches their early 30s. Over that 17 year period the number of households increased an annual average of 1.53 million units. It should be noted that the trend toward delayed marriage, increasing numbers of singles and increasing numbers of elderly living alone has actually strengthened the increasing number of households headed by this cohort. However, as indicated in Table 1, by the late 1990s, the rate of increase in households is expected to fall as households formed by the baby boom cohort reaches its stage of maturity, and, the next generation of young (1965-1975) entering their 20s and 30s shrink in absolute numbers. Although, if the trend toward delayed marriages, fewer children, increasing numbers of singles, and increasing number of elderly living alone continues for this younger cohort, the fall in the growth of households will be slowed, as more of these cohorts choose independent living arrangements. One important change has been an increase in one-person households which, in absolute numbers, has more than doubled since 1970. Of all households in the United States, one-person households increased from 17.1 percent in 1970, to 22.7 percent in 1980 and up to 24.0 percent in 1988. (See Table 1.)

Some major demographic trends influencing the rate at which people choose independent living arrangements and/or to remain single include the increase in the number of women entering the labor force (resulting in greater financial independence), the prevalence of divorce, increasing numbers of widows(ers) due to longevity, and the change of societys acceptance of later marriages and the resulting marketing schemes targeted specifically for single people, re-enforcing the notion that it is 'OK' to be single.

Labor force participation rates for women of prime working age (25-54) represented 22.1 percent of the civilian work force in 1972, 25.3 percent in 1979, 29.8 in 1986, and is projected to increase to 34.4 percent by the year 2000. (See Table 2.) In 1986, an estimated 70.8 percent of all women ages 25-54 were in the labor force, while 80.8 percent are expected to be in the labor force by the year 2000.[1] The overall participation rate for women increased from 43.9 percent in 1972 to 55.3 percent in 1986. (See Table 3.)

Increasingly, regardless of child bearing years, when todays women enter the work force they are there to stay. A greater number of todays women are electing to remain at work for several reasons: Price appreciation of housing has exploded over the past 10 years and in order to attain the "American Dream" of homeownership, dual earner households are often necessary to meet monthly mortgage home payments, this, though, does not equate necessarily to the necessity of marriage to solve the need for dual income earners with regard to the purchase of a home. Individuals may choose to co-habitat without marital intention and or to join into a partnership with the sole purpose of purchasing a home. Todays women are more educated and often feel compelled to use their expertise to the extend that they consciously choose to remain at work, and in the event that they have children, will choose to purchase the labor of home care for their children. Many women and men are choosing to delay both marriage and child bearing until their mid to late 30s - opting for the opportunity to pursue their careers and attain financial independence. Often professional single women and men will purchase a home either independently and/or co-buy with a partner or an investor. Co-buying with an investor has become more common in recent years, where the buyer and investor will enter into an agreement where the investor will finance a negotiated sum in return for a share of the equity in the home. The decision to remain 'single' no longer equates necessarily to singles 'renting' their living accommodations. Singles, particularly those without children tend to have the opportunity to concentrate on their professional careers, leading to promotions and thus increasing their percentage amount of disposable income. Disposable income is often directed into tax incentive saving, such as the purchase of a new or an existing single family home or condominium.

The repercussions of the baby-bust generation entering the work force is interesting. According the U.S. Bureau of Census, in the year 2000 the civilian labor force comprised of 20-34 year olds is projected to reach 45.41 million, down 9.25 percent from the 1986 level of 50.03 million.[2] With the fall in absolute numbers of civilians, in the labor force, high demand for employees and falling supply of labor will push up wages paid to employees both skilled and unskilled, ceteris paribus. Assuming that wages increases greater than inflation, disposable income for most workers between 20-34 will increase. Greater affluence among this cohort is guaranteed to be more wide spread compared to that of their predecessor. This (an increase in disposable income), combined with the trend toward individuals to postpone marriage and/or have fewer children will improve their financial position well above that of the baby boom generation - improving their purchasing power to invest in the American Dream, a home.

Also, one may decide to re-single due to the choice of divorce. In 1981 the total number of divorces peaked at 1.2 million. And, in 1987 an estimated 8.0 percent of all divorced households (4.8 million) continued to own their home compared to 5.2 percent in 1977 (2.5 million).[3] When households split or uncouple due to divorce it is commonly thought that one household becomes two households, of course there is always the situation where one divorcee may choose to return to a parents home or to join an existing group house. But generally speaking, especially when children are involved, two households are generated in the event of uncoupling. In recent years the percent of divorced households to all households has been on the

Table 1

TOTAL HOUSEHOLDS BY MARITAL STATUS, 1970-1988 AND PROJECTIONS TO 2000

Year	Total Households (thousands)	Annual Growth Rate	% Married Couples	% Single Persons	% Other Family	% Non-Family
1970	63,401	-	70.5%	17.1%	10.0%	1.7%
1975	71,120	2.43%	66.0	19.6	12.1	2.3
1980	80,776	2.71	60.8	22.7	12.9	3.6
1981	82,368	1.97	59.8	23.0	13.3	3.9
1982	83,527	1.41	59.4	23.2	13.7	3.7
1983	83,918	0.47	59.5	22.9	13.7	3.9
1984	85,407	1.77	58.6	23.4	14.0	4.0
1985	86,789	1.62	58.0	23.7	14.3	4.0
1986	88,458	1.92	57.6	23.9	14.3	4.2
1987	89,479	1.15	57.6	23.6	14.5	4.3
1988	91,061	1.77	56.9	24.0	14.6	4.4

5-Year Projection

Year	Total Households (thousands)	5-Year Growth Rate
1970	63,401	-
1975	71,120	12.2%
1980	80,776	13.6
1985	86,789	7.5
1990	94,227	8.6
1995	100,308	6.5
2000	105,933	5.6

SOURCES: U.S. Bureau of the Census, Current Population Reports, Series P-23, No. 150, Population Profile of the United States: 1984/85, U.S. Government Printing Office, Washington, D.C., 1987, Table A-1, pp. 44-45; U.S. Bureau of the Census, Statistical Abstract of the United States: 1989 (109th edition), U.S. Government Printing Office, Washington, D.C., 1989, Tables 58 and 59, p. 45; and Thomas Exter "Census Bureau's Household Projections," American Demographics, Vol. 8 (Oct. 1986), p. 47.

Table 2
CIVILIAN LABOR FORCE DISTRIBUTION AND GROWTH RATES, 1972, 1979, 1986 AND PROJECTED FOR 2000

Group	Percent Distribution				Annual Rate of Change	
	1972	1979	1986	2000	1972-79	1986-2000
Women 16 and Over	38.5%	42.1%	44.5%	47.3%	4.1%	1.6%
16 - 24	10.3	11.2	9.4	8.0	4.0	NA
25- 54	22.1	25.3	29.8	34.4	4.8	2.2
55 and Over	6.1	5.6	5.2	4.9	1.4	0.7
Men 16 and Over	61.5	57.9	55.5	52.7	1.8	0.8
16 - 25	12.9	13.0	10.4	8.3	2.8	-0.4
25 - 54	38.1	36.1	37.7	38.2	1.9	1.3
55 and Over	10.5	8.7	7.4	6.2	--	-0.1
Total 16 and Over	100.0	100.0	100.0	100.0	2.7	1.2

SOURCE: Howard N. Fullerton, Jr., "Projections 2000, Labor Force Projections: 1986 to 2000," Monthly Labor Review, (September 1987), p. 20.

Table 3
CIVILIAN LABOR FORCE PARTICIPATION RATES, BY SEX AND AGE 1972, 1979, 1986 AND PROJECTED FOR 2000

Group	1972	1979	1986	2000
Men 16 and Over	79.0%	77.8%	76.3%	74.7%
16 to 19	58.1	61.5	56.4	60.2
20 to 24	83.9	86.4	85.8	87.5
25 to 34	95.7	95.3	94.6	93.6
35 to 44	96.4	95.7	94.8	93.9
45 to 54	93.2	91.4	91.0	90.1
55 to 64	80.4	72.8	67.3	63.2
65 and Over	24.3	19.9	16.0	9.9
Women 16 and Over	43.9	50.9	55.3	61.5
16 to 19	45.8	54.2	52.9	59.2
20 to 24	59.1	69.0	72.4	78.4
25 to 34	47.8	63.9	71.6	82.3
35 to 44	52.0	63.6	73.1	84.2
45 to 54	53.9	58.4	65.9	75.4
55 to 64	42.1	41.7	42.3	45.8
65 and Over	9.3	8.3	7.4	5.4
Total 16 and Over	60.4	63.7	65.3	67.8

SOURCE: Howard N. Fullerton, Jr., "Labor Force Projections: 1986 to 2000," Monthly Labor Review, (September 1987), p. 25.

decline, reverting back to its mid 70s level. In 1977 divorce households represented 8.1 percent of allhouseholds, that number peaked in 1987 at 11.6 percent, but in 1987 the number of divorced householdswas only 8.0 percent. Reasons for this reversal are many, delayed marriage and the decision to remain single are among them. Marriages that occur at younger ages (as was typical in the 60s and 70s) tend to have a higher rate of divorce. With the trend toward postponing marriage to later years, one tends to be more mature and committed to a long lasting monogamous partnership. Also, with the recent threat of deadly diseases, couples are more apt to remain monogamous and work harder at maintaining that partnership. It is still probably true that when a household splits the income of the male increases while that of the women falls, but with increasing numbers of women in (and remaining in) the labor force, the number of divorced households that 'own' their homes may continue to increase as has statistically proven to be the case. The increasing participation rate of women in the work force may in fact be the reason for the increase in the number of divorced households owning their homes.

Though we have painted a rather positive scenario for single and/or re-single people and their ability to purchase a home with or without a partner, there still remains those who will not earn enough income to join in the ranks of homeownership, regardless of the partnership option. Appropriate housing supply may be found to be in short supply. Gone are the days of 'Levittown', where, after World War II veterans returned home to find an acute shortage of housing supply. Mr. William J. Levitt created the idea of mass producing small houses built on concrete slabs. Levittown housing is rarely constructed now-a-days and todays costs for residential building, small or large, have been pushed up considerably by political factors such as "restrictive zoning ordinances, elaborate and time-consuming building permit processes, and land use restrictions."[4]

Too, 'trade-up' houses may not be the answer to the solution for lower income singles, re-singles, and first-time homebuyers. With the elderly population living longer and choosing to both maintain their residence and live alone instead of living in an in-law apartment or housing for the elderly, may compound the problem of affordable housing. For single people who choose to live alone, some can not afford a large home, typical of those being built today. With the smaller number of population(baby bust), along with the increasing number of elderly living alone, and couples choosing to have smaller families, and also the shrinking of the middle-class, homebuilders will eventually respond to the market demand for smaller and more efficient housing. This is evident in Alexandria Virginia, where "people can't afford to go out and buy a standard single-family home... so what you're looking at in the future are smaller units. People are going to have to be satisfied with living in smaller spaces... only as a starting home".[5] According to J. Tuccillo, Chief Economist at the National Association of REALTORS "..changes we can expect to see in the market will be the continued move toward an even more complex financial market and an older population that will include fewer new households and smaller-sized households. As a result the demand for housing needs will be much different than it is today."[6] In the future, the real estate industry must recognize these changes and respond quickly to changing demographics. This is not to say that large and amenity filled homes will not be in demand for those singles who can afford them. For the more affluent, there will always be a 'supply,' whether it be a house or caviar. For those higher income individuals who prefer a large home they will have the option of purchasing a house from the existing stock of inventory or simply build a new one.

by
Ann Mulvaney
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Economics and Research Division

1. Howard N. Fullerton, Jr., "Projections 2000, Labor Force Projections: 1986 to 2000," Monthly Labor Review, (September 1987), p.24.

2. Ibid., p.24.

3. Calculations based on data from U.S. Department of Commerce, Bureau of the Census, Current Population Reports, Series P-23, No. 150, Household and Family Characteristics [annual 1977-1987], U.S. Government Printing Office, and Population Profile of the United States 1984/85, Bureau of the Census, Washington, D.C.

4. Longman, Phillip. "The Mortgaged Generation: Why the young can't afford a house". Washington Monthly, April 1986, p.47.

5. Scannell, Nancy. "The Quest for Shelter". The Washington Post, April 28, 1982, p. 14.

6. Roketenetz Annemarie. 1989, "EOs hear speakers, share ideas during Boston seminar", REALTOR News, Volume 10, No. 8 April 24, 1989, p. 4.

U.S. ECONOMIC OUTLOOK

NOVEMBER 1989

	QUARTERS										YEARS		
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	1989.2	1989.3	89.4	90.1	90.2	90.3	90.4	91.1	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5202	5273	5346	5430	5499	5569	5640	5728	4524	4881	5233	5534	5860
% Change	7.1	5.6	5.6	6.4	5.2	5.2	5.2	6.4	6.9	7.9	7.2	5.8	5.9
% Change (w/out inflation)	2.5	2.5	1.8	1.8	1.4	1.5	1.6	2.3	3.7	4.4	3.0	1.8	2.1
Consumer Price Inflation (CPI)	6.4	2.4	3.7	4.2	3.9	4.2	4.1	4.1	3.7	4.1	4.8	4.0	4.1
GNP Inflation (GNP Deflator)	4.6	2.9	3.8	4.6	3.8	3.7	3.6	4.0	3.1	3.3	4.2	3.9	3.7
Unemployment Rate - Civilian	5.3	5.2	5.3	5.4	5.5	5.5	5.6	5.7	6.2	5.5	5.3	5.5	5.6
Civilian Employment-Household Basis (millions)	117.3	117.5	117.7	117.9	118.2	118.4	118.6	118.9	112.4	115.0	117.3	118.3	119.4
Percent change	1.3	0.7	0.5	1.0	0.8	0.8	0.7	0.9	2.6	2.3	2.1	0.8	1.0
Index of Industrial Production	141.8	142.2	142.4	143.1	143.5	144.1	144.7	145.4	129.8	137.2	141.8	143.9	146.8
Manufacturing Capacity Utilization	84.4	84.0	83.6	83.5	83.5	83.6	83.7	83.7	81.0	83.6	84.1	83.6	83.6
Domestic Auto Sales	7.3	7.9	6.5	6.8	6.8	6.9	6.9	7.0	7.1	7.5	7.2	6.8	7.0
Federal Tax Receipts (NIPA) as % of GNP	20.2	19.7	19.7	20.4	20.5	20.5	20.5	20.5	20.1	19.9	20.0	20.5	20.5
Federal Expenditures (NIPA) as % of GNP	23.0	22.6	22.7	22.7	22.6	22.6	22.5	22.7	23.7	22.9	22.9	22.6	22.5
Deficit(NIPA)	-145.4	-152.9	-156.9	-125.3	-118.2	-118.7	-117.3	-125.6	-161.3	-145.9	-150.7	-119.9	-121.8
as % of GNP	-2.8	-2.9	-2.9	-2.3	-2.1	-2.1	-2.1	-2.2	-3.6	-3.0	2.9	-2.2	-2.1
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4286	4446	4360	4278	4383	4433	4402	4410	4633	4650	4402	4374	4443
Percent change -- year ago	-8.2	-5.2	-10.5	-5.2	2.3	-0.3	1.0	3.1	-1.6	0.3	-5.3	-0.6	1.6
Existing Single-family Home Sales (thousands)	3323	3480	3355	3245	3339	3404	3389	3408	3512	3594	3409	3345	3450
Percent change -- year ago	-8.8	-5.0	-11.0	-6.7	0.5	-2.2	1.0	5.0	-1.4	2.3	-5.2	-1.9	3.2
Housing Starts (thousands)	1352	1338	1406	1452	1466	1460	1448	1444	1634	1495	1404	1457	1435
Percent change -- year ago	-8.4	-8.8	-9.8	-4.3	8.4	9.1	3.0	-0.5	-9.8	-8.5	-6.1	3.8	-1.5
Single-Family Units	993	996	1037	1065	1076	1061	1044	1034	1156	1088	1024	1061	1024
Percent change -- year ago	-6.2	-6.1	-8.9	-0.4	8.4	6.4	0.7	-3.0	-2.2	-5.9	-5.9	3.7	-3.5
Multi-Family Units	360	342	370	387	390	400	405	411	477	407	380	395	411
2-4 Family Units	53	54	58	61	61	63	64	65	65	59	56	62	65
Percent change -- year ago	-8.1	-5.8	-11.2	2.3	15.4	16.9	9.5	6.2	-23.0	-9.5	-5.1	10.7	4.0
5 + Family Units	307	288	312	326	329	337	341	346	412	348	324	333	347
Percent change -- year ago	-15.0	-17.4	-12.2	-16.1	7.1	16.9	9.5	6.2	-24.4	-15.6	-6.9	2.9	4.0
New Single-family Home Sales (thousands)	636	693	628	546	577	610	588	616	673	677	646	580	649
Percent change -- year ago	-8.8	-1.1	-7.5	-12.7	-9.2	-12.0	-6.3	12.9	-9.6	0.5	-4.6	-10.1	11.8
HOME PRICES													
Existing Home Prices - Median $(1000)	93.0	95.0	94.5	96.2	97.9	100.2	99.7	101.4	84.9	88.9	93.4	98.5	103.4
Percent change -- year ago	4.6	5.3	6.6	5.4	5.3	5.5	5.5	5.4	5.8	4.7	5.1	5.4	5.0
New Home Prices - Median $(1000)	119.5	120.6	123.2	123.4	126.3	127.3	128.4	129.7	104.7	113.9	120.3	126.3	133.1
Percent change -- year ago	5.8	4.9	7.3	4.6	5.7	5.6	4.3	5.1	13.5	8.8	5.6	5.0	5.4
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.5	9.8	9.8	9.6	9.4	9.4	9.5	9.7	10.2	10.5	10.3	9.5	9.8
1-year ARM (effective rate)	9.7	9.7	9.5	9.2	9.0	9.0	9.1	9.2	8.5	8.5	9.7	9.1	9.3
Corporate AAA Bond Rate	9.5	9.0	8.8	8.6	8.3	8.3	8.5	8.5	9.4	9.7	9.2	8.4	8.8
Government Bond Rate	8.7	8.1	7.9	7.7	7.5	7.5	7.6	7.8	8.6	9.0	8.4	7.6	8.0
Short-Term Interest Rates													
Federal Funds Rate	9.7	9.1	8.6	8.3	8.0	8.1	8.2	8.4	6.7	7.6	9.2	8.2	8.4
3-month T-Bill Rate	8.4	7.8	7.6	7.3	7.0	7.2	7.2	7.4	5.8	6.7	8.1	7.2	7.4
Prime Rate	11.4	10.7	10.3	10.0	9.8	9.8	9.7	9.7	8.2	9.3	10.8	9.8	9.8
Discount Rate	7.0	7.0	7.0	7.0	6.7	6.5	6.5	6.5	5.7	6.2	6.9	6.7	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	100.4	100.5	97.9	96.2	93.9	91.8	90.4	89.7	96.9	92.8	98.7	93.1	89.9
Percent change	19.7	0.4	-9.8	-6.9	-9.3	-8.5	-5.8	-3	-13.6	-4.3	6.4	-5.7	-3.5

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

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REAL ESTATE OUTLOOK

Vol. 2, No. 12

December 1989

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The Department of Commerce released its first revision to third quarter real GNP growth, declaring that the economy advanced at an annual rate of 2.7 percent, a shade faster than its initial estimate of 2.5 percent. The upshot is that demand appears to have been stronger, while worrisome levels of inventory building were less alarming than originally thought.
- The Commerce Department reported that the index of leading economic indicators, slipped 0.4% in October, following two months of increases. To date in 1989, the index has fallen five times, increased four, and remained unchanged once.
- Housing starts activity rebounded in October to an annual rate of 1.42 million units, 12.0 percent faster than the September pace of 1.268 million units, but 7.3 percent below the October 1988 annual rate of 1.532 million units. Single-family housing starts moved up 6.9 percent to an annual rate of 1.027 million units, but were 9.6 percent below their October 1988 pace of 1.136 million units. Starts of multi-family units were also up strongly in October.
- October sales of existing single-family homes reacted positively to lower interest rates, remaining unchanged from their healthy September annual rate of 3.52 million homes. The pace of existing home sales was 4.3 percent below the October 1988 annual rate of 3.68 million units.
- Despite the healthy pace of existing single-family home sales, the median price of an existing single-family home slipped $2,200 to $92,100 in October, a decline of 2.3%. The median price for new single-family homes was up 5.3 percent in October to $127,900, and had risen 13.3 percent from its October 1988 median price of $112,900.

IN THIS ISSUE

- **Economic Commentary: [illegible] THE DECADE, by John A. Tuccillo**
- **Outlook [illegible]**
- **[illegible], by John Simonson [illegible]**

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VALEDICTORY FOR THE DECADE

Economic Commentary

If you believe in forever,
Then life is just a one night stand.
If there's a rock n'roll heaven,
They're sure to have a hell of a band.

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

Yes, but decades pass and it's only human to mark their passage with some retrospection, a process in which economists achieve 50 percent accuracy. In a few weeks, we move into a new decade (OK, don't quibble--I know that the Nineties don't really start until January 1, 1991, but see how many people invite you to their turn of the century party on December 31, 2000!). What did the Eighties represent? What did we accomplish? What lessons do we take with us toward the third millennium?

It was a decade that came in with the bang of Mt. St. Helens and went out with the twin scourges of Hugo and the quake. We learned that our friends at the beginning of the Eighties, the Japanese, may not be our friends by the end, but that old enemies are no longer as adversarial, as the Wall came tumbling down. Chernobyl and the Exxon Valdez showed the real costs of progress; our discards came back to haunt us, both as physical trash choking the environment and the human beings trapped by drug dependency and illiteracy.

We also learned that while democracy is, in the words of Winston Churchill, "the worst form of government, except for all the rest", it is the most difficult to sustain. Our elections became financial and media extravaganzas, and produced Congresses that have become increasingly paralyzed simply trying to produce an annual budget. That the Eighties were dominated by Ronald Reagan is as much a reflection of the changing ground rules of our political system, as it is a barometer of the needs of the country.

In economic terms, the decade was a resounding success. The nation is moving into the eighth consecutive year of growth, and even our two largest failures, the collapse of the thrifts and the stock market crash, appear to have had little lasting impact on either the housing finance system or the economy at large. Americans simply brushed aside the bad news in their rush to follow the advice of Barrett Stong, "The best things in life are free, but you can give them to the birds and bees. I need money, that's what I want."

Let's look at some of the major economic lessons of the Eighties:

Capitalism is a powerful force. Is there any doubt that the wave of freedom sweeping over the Communist world from China to East Germany stems from the powerful example of the prosperity achieved in the U.S., Western Europe and Japan? More to the point (and perhaps difficult to stomach), drug trafficking would not be nearly as successful and as hard to eliminate as it is were it not organized as a capitalist enterprise. In 1981, Reaganomics brought us back to the principles on which this economy was founded, and unprecedented growth resulted. That example has been taken to heart by many others in many ways.

Short-run wisdom and long-run wisdom don't always coincide. The free love of the Seventies turned out not to be free after all, as compelling as was its case. Also in the Seventies, what looked like a good idea--using the flood of young baby-boom workers to produce goods, rather than renewing obsolete capital--placed us in a dramatically inferior economic position to Japan and Germany. On the brighter side, the recession of 1981-82 engineered by the Volcker Fed seemed awful at the time, yet successfully squeezed inflation out of the economy and set the stage for the strong growth during the rest of the decade.

What goes up must come down. Not too long ago, we viewed the Communist Bloc as a monolithic superpower. And in 1980, Dallas and Houston were the places to be, and interest rates and oil prices were skyrocketing. Forecasts made at that time by extrapolating trends were dead wrong. And while it's true that economists have predicted eight of the last two recessions, it's human nature to assume that what happened yesterday will happen forever. Ain't so, and during the Eighties we learned that good markets turn sour, and bad markets improve. Think about that the next time you're tempted to worry about the Japanese.

Markets work. The most striking thing about the thrift debacle has not been its size or its cost or the numbers of institutions affected. Rather, it's that there has been no noticeable disruption of the housing finance system. The reason here is that the financial market found ways around the regulations that bound mortgage transactions. The upshot was the creation of an alternative system that took up the slack generated by the loss of the thrifts.

So those were the Eighties. The Nineties will bring their own triumphs and disasters, and we'll learn more lessons in the inexhaustible complexity of human existence. But can the end of the century really be so near? Has Saturday Night Live really been on for fifteen years? Is Mick really forty-six?

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The Department of Commerce released its first revision to third quarter real GNP growth, declaring that the economy advanced at an annual rate of 2.7 percent, a shade faster than its initial estimate of 2.5 percent. However, the composition of the new growth estimate changed substantially with the revision. Essentially, final sales in the economy (broadly defined as total demand less change in inventories) moved up by a full percentage point, and inventory change moved down by almost as much. The upshot is that demand appears to have been stronger, while worrisome levels of inventory building were less alarming than originally thought. However, the after effects of Hugo are still swirling amidst these revisions. By one measure, the net increase in the real GNP estimate can be explained by insurance payments made by foreign companies in the wake of Hugo. The statistical minutiae aside, the economy still seems on course for the vaunted "soft landing," although recent indicators suggest the approach might get a bit bumpy.

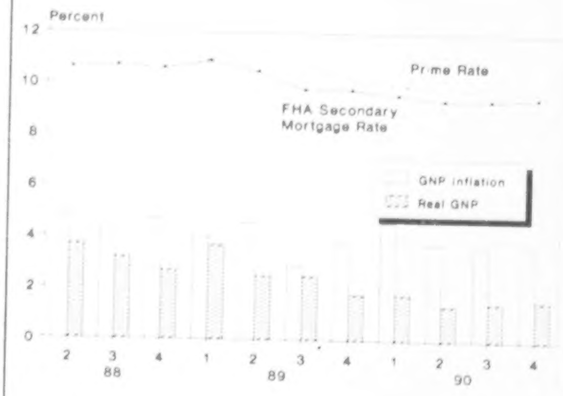
Outlook Mixed, Leading Indicators Say

The Commerce Department reported that its chief forecasting tool, the index of leading economic indicators, slipped 0.4% in October, following two months of increases. The index is popular because it is a composite of 11 indicators of economic activity which were selected to predict activity six to nine months in the future. It is believed that three consecutive monthly declines indicate a recession is probable. To date in 1989, the index has fallen five times, increased four, and remained unchanged once. In October, the index was buoyed by fewer unemployment claims, increases in plant and equipment orders, and a rise in building permits. The six components contributing to the October decline were all related to manufacturing: a shorter average workweek, slower orders for consumer goods, faster delivery times, less of a backlog for durable goods, higher material prices, and sagging consumer expectations. Any one month's report on the leading indicators should always be evaluated carefully, but other data confirms that the manufacturing sector has weakened significantly in recent months.

Sluggish Manufacturing Sector

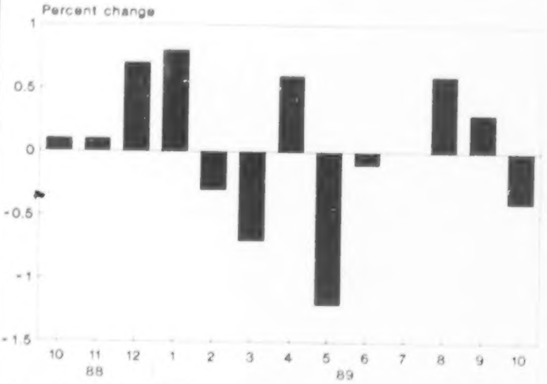
More concrete evidence of a slowdown in manufacturing has appeared with striking regularity in the monthly survey of purchasing agents by the National Association of Purchasing Managers. The November report marked the seventh consecutive month for which the index fell below a reading of 50. Generally, readings below 50 indicate that the manufacturing sector is extremely soft. Important trends in a few components of this composite index included the fifth consecutive monthly decline in factory production, the tenth consecutive monthly drop in manufacturing employment, and a decline in new orders for manufactured goods. The industrial sector has been going through a period of adjustment brought on by both weaker domestic demand and recently sluggish export growth. On a positive note, this slack demand has eased pressures for higher prices in some industries, and this may ultimately lead the Federal Reserve to lower interest rates.

GRAPH 1: THE ECONOMIC OUTLOOK



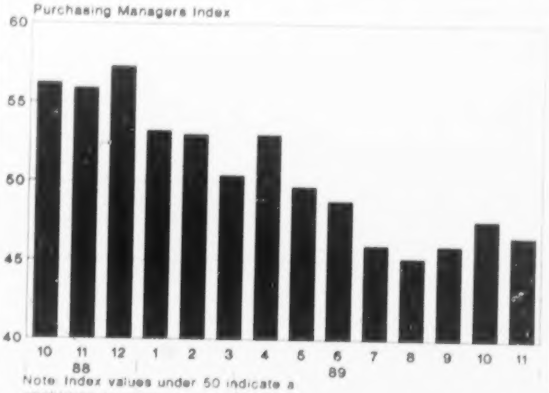
Source: Bureau of Economic Analysis; E NAR estimates.

GRAPH 2: LEADING INDICATORS WEAKEN



Source: Dept. of Commerce

GRAPH 3:FACTORIES SLOW, PURCHASERS SAY



Note: Index values under 50 indicate a weakening economy.
Source: Natl. Assn. Purchasing Managers

Will the Consumer Be Back in Time for Xmas?

With manufacturing enduring a slowdown, the indomitable spirit of the American consumer has again been looked to for help in propping up economic growth. In fact, much of the 2.7% advance in third quarter real GNP growth was due to consumer spending. On the surface, it seems that consumers are still up to the task: personal income growth surged 0.9% in October, the fastest pace since March, and just in time for the Christmas buying season. But a host of special factors were behind the income spurt: bonus checks for auto execs, and the earthquake, to name two. But while it's still too early to tell, there are signs consumers are winded from their stint at the forefront of economic growth. October retail sales were down 1.0 percent from September, but up 4.6 percent from October 1988. The October decline was the largest since January 1987, but both then and now the retreat was due to sharp drops in auto sales. Excluding auto sales, October retail sales were up 0.2 percent. So, a late Christmas season comeback should not be ruled out. Retailers did report that sales picked up after Thanksgiving, so Christmas might just come a little late this year: particularly with five shopping weekends between the holidays this year.

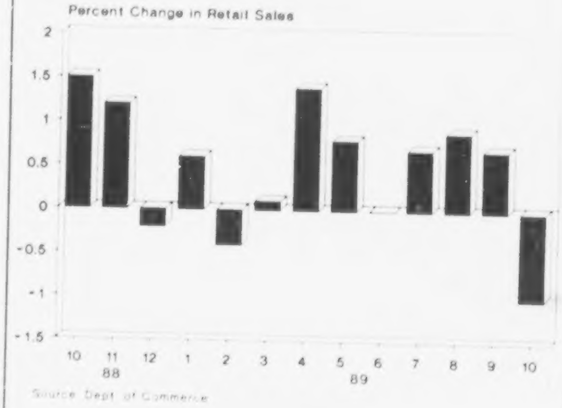
Slower Auto Sales Are Just a Symptom

Flat auto sales are muffling consumer spending as well. October was the first month in which Americans curbed their personal spending in more than a year, and sagging car sales were almost entirely to blame for the 0.2% drop. There was a time not too long ago that an extended stay in the Detroit doldrums meant a recession was likely for the entire economy. But in 1989, auto production at partially or wholly-owned Japanese plants in the U.S. will surpass one million units. These plants operate at lower costs than older ones run by the Big Three U.S. car companies. With these margins in their favor, Japanese auto makers have enjoyed an 8.2% rise in sales from January to October 1989, and in the process, have grabbed a 25.4% share of the market, up almost three percentage points. Sales at the Big Three have plunged 6.2%, trimming their combined share by 1.6%.

Slow Growth, Modest Inflation...Lower Rates?

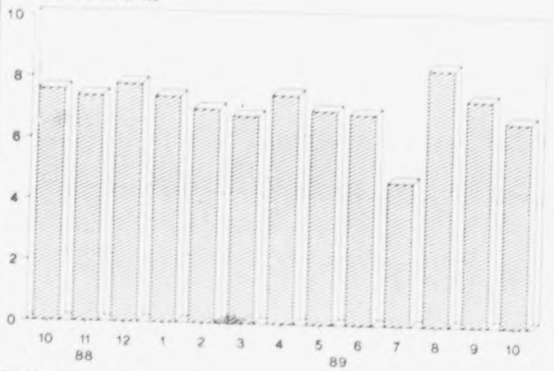
As evidence of the economy's slower growth trend mounts, expectations grow that the Federal Reserve will soon ease its monetary policy and thereby allow interest rates to drift down again. The Fed is widely believed to be a bit more concerned with keeping the economy out of a recession, than it is worried about an acceleration in the rate of inflation. In fact, the Fed's next move to ease credit is so widely anticipated that many financial market wizards claimed to see ghosts of looser credit during the short Thanksgiving week. The markets reacted so strongly to these sightings that the Fed had to enter the markets on the following Monday to realign the federal funds rate to confirm that it had only been providing more credit to meet the needs of the busy shopping weekend. Still, the Fed is expected to loosen credit before the year is out. This easing of credit might be precipitated by a weak November employment report, which is due to be released on Friday, December 8.

GRAPH 4: RETAILERS WAIT FOR XMAS



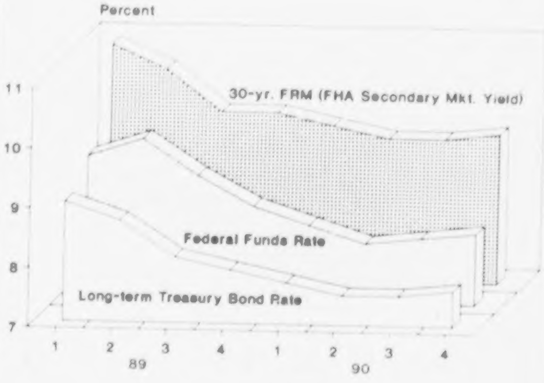
Source: Dept. of Commerce

GRAPH 5: AUTO SALES PLUNGE



Source: Dept. of Commerce

GRAPH 6: INTEREST RATE OUTLOOK



Source: Federal Reserve, NAR Estimates

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

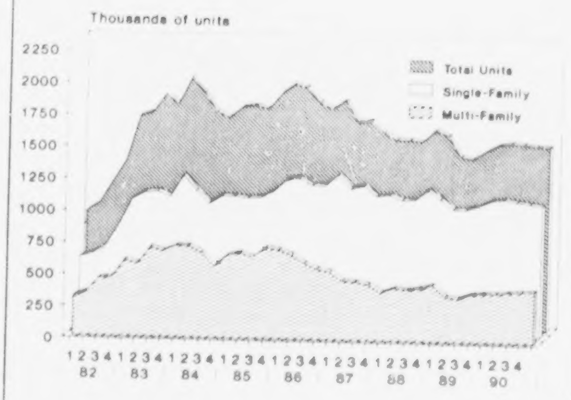
	Total	S-F	2-4	5 and up
Oct 1989	1420	1027	73	320
Sep 1989	1268	961	59	248
Aug 1989	1329	990	56	283
Jul 1989	1420	1026	57	337
Jun 1989	1406	972	55	379
Oct 1988	1532	1136	63	333
Oct 1989 Changes From (%):				
Sep 1989	12.0	6.9	23.7	29.0
Oct 1988	-7.3	-9.6	15.9	-3.9

REGIONAL DATA

	Northeast	Midwest	South	West
Oct 1989	176	289	562	393
Sep 1989	166	248	480	374
Aug 1989	140	236	563	390
Jul 1989	189	274	531	426
Jun 1989	168	242	552	444
Oct 1988	198	273	582	479
Oct 1989 Changes From (%):				
Sep 1989	6.0	16.5	17.1	5.1
Oct 1988	-11.1	5.9	-3.4	-18.0

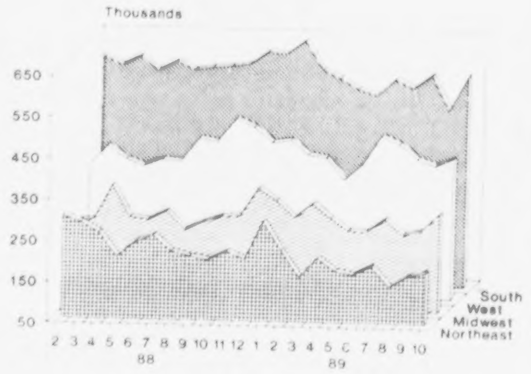
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Privately owned housing starts activity rebounded in October to an annual rate of 1.42 million units, 12.0 percent faster than the September pace of 1.268 million units, but 7.3 percent below the October 1988 annual rate of 1.532 million units. Single-family housing starts moved up 6.9 percent to an annual rate of 1.027 million units, but were 9.6 percent below their October 1988 pace of 1.136 million units. Starts of multi-family units were also up strongly in October. The rebound in activity was directly related to the recent drop in interest rates, and does not indicate a reversal of the slowdown in the general economy. Rather, the latest starts figures simply moved starts activity back up to the pace that had prevailed in July before plunging 6.4% in August and 4.6% in September.

All four regions experienced an increase in the rate of housing starts activity during October, but only the Midwest saw starts surpass their October 1988 pace. In the Midwest, housing starts rose 16.5 % in October to an annual rate of 289 thousand homes, and were 5.9% higher than their October 1988 pace of 273 thousand units. In the Northeast, October housing starts were up 6.0% from September, but down 11.1% from a year ago. In the South, starts surged 17.1% in October, but were off 3.4 % from their October 1988 pace. In the West, housing starts rose 5.1% in October, but were down 18.0% from their October 1988 annual rate.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Oct 1989	649	Mar 1989	555
Sep 1989	652	Feb 1989	621
Aug 1989	726	Jan 1989	700
Jul 1989	738	Dec 1988	669
Jun 1989	647	Nov 1988	650
May 1989	653	Oct 1988	718
Apr 1989	607		

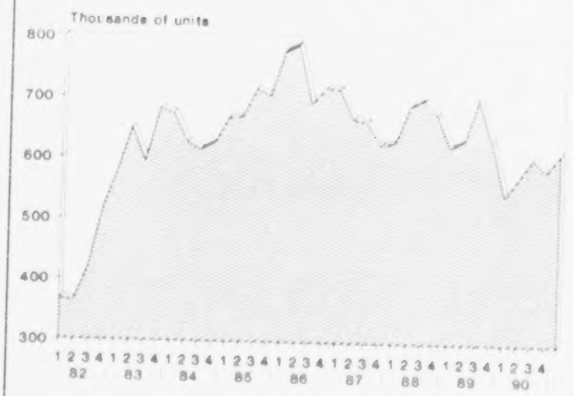
Oct 1989 Changes From:		Annual Totals:	
Sep 1989	-0.5	1987	671
Oct 1988	-9.6	1988	676

REGIONAL DATA

	Northeast	Midwest	South	West
Oct 1989	99	113	276	161
Sep 1989	67	109	261	214
Aug 1989	88	104	293	241
Jul 1989	99	127	282	229
Jun 1989	73	99	259	215
May 1989	89	99	271	195
Oct 1988	96	111	274	238
1988	102	97	276	202
1987	117	97	271	186
Oct 1989 Changes From:				
Sep 1989	47.8	3.7	5.7	-24.8
Oct 1988	3.1	1.8	0.7	-32.4

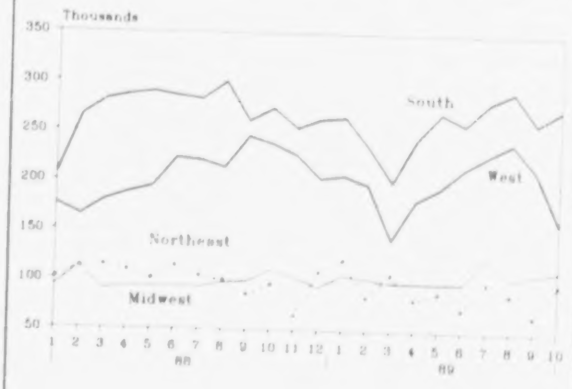
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census, Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

Sales of new single-family homes were virtually unchanged in October at an annual rate of 649 thousand units, or 0.5% below the September annual rate of 652 thousand units. New home sales figures can and do fluctuate wildly from month to month. In fact, September new home sales were initially reported last month to have fallen 14% from their August pace, but the Bureau of Census revised this figure to a smaller 10.2% decline. The November and December reports on new home sales may show a slight uptick in activity due to lower interest rates during the fall, which has helped boost housing starts activity. However, the large sampling errors encountered by the Bureau of Census make drawing any inferences from the monthly data a treacherous undertaking.

By region, there were some very wide swings in new home sales activity. In the Northeast, new home sales shot up 47.8% to an annual rate of 99 thousand homes, but were only 3.1% faster than the October 1988 rate. In the Midwest, new home sales moved up 3.7% in October to an annual rate of 113 thousand homes, and were 1.8% above the October 1988 annual rate. In the South, new homes sold at an annual rate of 276 thousand units, or 5.7% faster than the September rate, and were virtually unchanged from the October 1988 pace. In the West, the annual rate of new home sales plunged 24.8% in October to 161 thousand units, from 214 thousand units in September. The October 1989 sales pace was 32.4 percent slower than the October 1988 annual rate of 238 thousand units.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Oct	1989	3520	Mar	1989	3400
Sep	1989	3520	Feb	1989	3480
Aug	1989	3480	Jan	1989	3550
Jul	1989	3330	Dec	1988	3920
Jun	1989	3360	Nov	1988	3710
May	1989	3210	Oct	1988	3680
Apr	1989	3400			

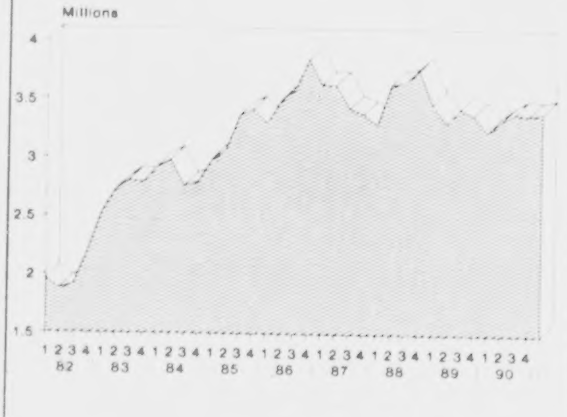
Oct 1989 Changes From (%):		Annual Totals:	
Sep 1989	0.0	1988	3594
Oct 1988	-4.3	1987	3526

REGIONAL DATA

	Northeast	Midwest	South	West
Oct 1989	580	980	1340	610
Sep 1989	590	990	1340	590
Aug 1989	590	980	1350	550
Jul 1989	550	910	1300	570
Jun 1989	510	960	1280	600
May 1989	610	810	1230	580
Oct 1988	640	940	1410	690
1988	673	929	1350	642
1987	685	959	1282	600
Oct 1989 Changes From (%):				
Sep 1989	-1.7	-1.0	0.0	3.4
Oct 1988	-9.4	4.3	-5.0	-11.6

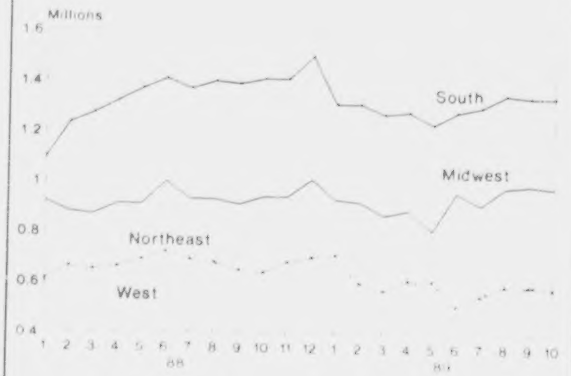
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

October sales of existing single-family homes reacted positively to lower interest rates, remaining unchanged from their healthy September annual rate of 3.52 million homes. The pace of existing home sales was 4.3 percent below the October 1988 annual rate of 3.68 million units. However, put in the context of sales activity during 1989, the October annual rate was the highest since January's pace of 3.55 million units. With fixed rate mortgages available at rates below 10 percent, buyers previously priced out of the market apparently have reconsidered their situation and jumped back into the market. However, buyers in high cost areas are still finding it difficult to purchase homes, despite the lower rates.

In the Northeast, the annual rate of existing home sales fell 1.7% in October to 580 thousand homes, and was 9.4% below the October 1988 annual sales pace. In the Midwest, sales slipped by only 1.0% to an annual rate of 980 thousand homes during October, and were 4.3% ahead of the October 1988 sales pace. In the South, sales of existing homes were unchanged in October at an annual rate of 1.34 million homes, but fell 5.0 percent below the October 1988 annual rate of 1.41 million units. In the West, October sales activity was up 3.4 percent to an annual rate of 610 thousand existing homes, but remained 11.6 percent below its October 1988 sales pace of 690 thousand homes.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

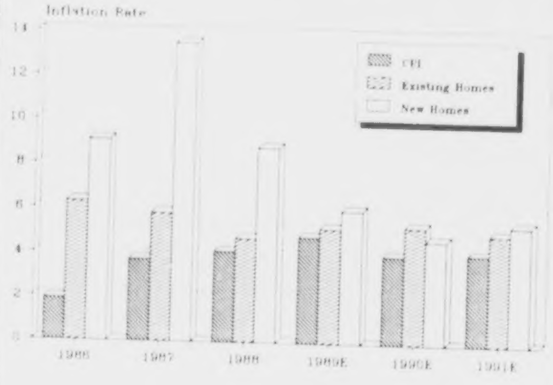
	Median Existing	Median New	Average Existing	Average New
Oct 1989	92,100	127,900	116,500	151,900
Sep 1989	94,300	121,500	118,400	151,900
Aug 1989	94,800	122,700	120,800	159,000
Jul 1989	96,700	116,000	122,100	140,300
Jun 1989	93,400	122,800	118,800	153,600
Oct 1988	88,900	112,900	112,300	137,300
1988	89,300	112,500	112,800	138,300
1987	85,600	104,500	106,300	127,200
Oct 1989 Changes From (%):				
Sep 1989	-2.3	5.3	-1.6	0.0
Oct 1988	3.6	13.3	3.7	10.6

REGIONAL DATA

	Northeast	Midwest	South	West
Oct 1989	143,300	70,900	83,400	142,200
Sep 1989	145,700	72,200	84,400	147,600
Aug 1989	149,000	71,900	86,100	147,500
Jul 1989	147,100	73,400	87,200	146,500
Jun 1989	149,900	72,000	85,000	134,500
Oct 1988	144,400	68,000	80,500	130,000
1988	143,000	68,400	82,200	124,900
1987	133,300	66,000	80,400	113,200
Oct 1989 Changes From (%):				
Sep 1989	-1.6	-1.8	-1.2	-3.7
Oct 1988	-0.8	4.3	3.6	9.4

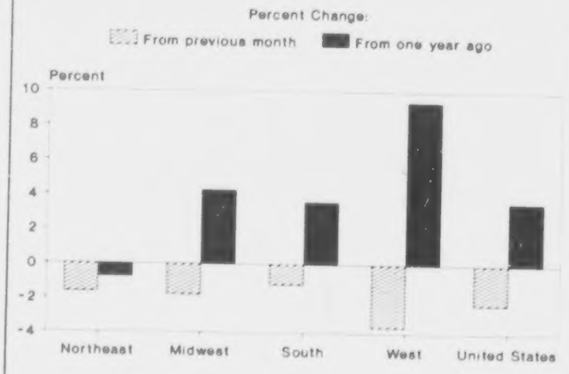
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

Despite the healthy pace of existing single-family home sales, the median price of an existing single-family home slipped $2,200 to $92,100, in October, a decline of 2.3%. The drop in interest rates that encouraged the healthy sales activity allowed buyers who had previously been priced out of the housing market to make purchases. This, in turn, contributed to a larger volume of home sales in the moderate price range, as those previously priced out of the market are not likely to purchase homes in the upper brackets. The median price declined in all four regions during October, but remained above October 1988 levels in every region except the Northeast, where it was 0.8 percent below its October 1988 reading. The Midwest median price increased 4.3 percent since October 1988, the South median price was up 3.6 percent, and the West median price was up 9.4 percent.

The median price for new single-family homes was up 5.3 percent in October to $127,900, and had risen 13.3 percent from its October 1988 median price of $112,900. But as mentioned earlier, sampling errors affect the new home sales data, and these wide swings in new home sales prices are more than likely linked to them.

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HOUSEHOLD HOUSING EXPENDITURES

Effects of A Changing Population

Given the cyclical nature of housing, it is understandable why the demand for housing is often represented primarily as a function of current and anticipated inflation, interest rates, the supply of mortgage credit, etc. However the longer run demand for housing, often obscured by "shocks" to the economy, responds to the population's demographics, including its changing age structure and household composition. In "Increasing Singles and Aging 'Boomers': Impacts on Household Finances and Implications for Housing" (Real Estate Outlook, August 1989), we looked at the financial resources of households of various types. Moreover, we humbly speculated about the implications for household formation and housing demand if current trends in finances, savings and income continue into the future.

This article will look at another aspect of housing demand. How much of their financial resources are households of various ages and types spending for housing services? How will this impact future demand? Both this article and "Increasing Singles and Aging 'Boomers'", are excerpted from an upcoming NATIONAL ASSOCIATION OF REALTORS® staff study, Demographics in the U.S. -- The Segmenting of Housing Demand.

THE HOUSING "HAVES" AND "HAVE NOTS"

A well-documented growing inequality in the income distribution is being reflected in a growing gulf between the "haves" and "have nots" in the housing market. While growth in housing affluence among households toward the upper end of the distribution has been characterized as "quite remarkable", the declining share of income going to poor households has contributed to equally apparent housing problems, if not deprivation, for many.[1] Between 1981 and 1987, there was substantial growth in the number and percent of higher priced homes sold. Some 356,000 existing homes were sold for $120,000 or more in 1981 (14.7 percent of the total); an estimated 726,000 were sold for $150,000 or more in 1987 (20.6 percent of the total).[2] The number of new homes sold at these prices increased by 155 percent between 1981 and 1987; as a share of total new home sales the increase was from 15 percent to 26 percent.[3] Much of this reflects increased demand by affluent households for more amenities and more spacious, well-appointed homes.[4]

A few select characteristics of new homes indicate how striking the supply response has been. From 1984 to 1988, median new home size increased over 13 percent (from 1,605 sq. ft. to 1,815 sq. ft.); the proportion with more than two baths increased from 28 percent to 42 percent; new houses with four bedrooms or more increased from 18 percent to 26 percent; and the proportion with two- or more car garages rose from 55 percent to 66 percent.[5]

In sharp contrast to the affluence evidenced by increased sales of higher priced homes, housing deprivation has increased appreciably as well. Deprivation occurs not only for those households which are homeless but also for those poverty households which are deprived of other essentials because they must spend enormous income shares for housing. The housing cost burden to poverty households varies across household types. Housing costs constitute an excessive burden for more poverty renters than owners, and for more poverty households under age 65 than for the elderly. It is estimated, for example, that the typical renter household having an income below the poverty level spent 65 percent of its income on housing in 1985. This compares with 35 percent for elderly renters, 31 percent for black renters, and 27 percent for all renter households. On the other hand, the typical poverty household which owned its home in 1985 spent 47 percent of its income on housing. This compares with 19 percent spent by elderly owners, 21 percent by black owners, and 18 percent by all owner household.[8]

Whereas nearly 4 out of 5 (78.6 percent) of poor renters under age 65 and living alone pay more than 50 percent of their incomes for housing, only about one-half (50.8 percent) of their elderly cohorts do so. For married couples without children the situation is somewhat reversed; a substantially larger proportion of poor elderly renter couples pay more than 50 percent of their incomes for housing than is true for married renter households under age 65 (83.6 percent versus 73.6 percent). Available evidence from the 1985 American Housing Survey indicates that, while spending substantial portions of their incomes for housing, low-income households which rent consume relatively low levels of housing. For example, the typical renter units occupied by a poverty household in 1985 provided 379 square feet of floor space per person, about 83 percent of the median (458 square feet) for all occupied rental units.[10]

EVIDENCE FROM CONSUMER EXPENDITURES SURVEYS

The most reliable data currently available regarding household expenditures are collected by the Bureau of Labor Statistics in its periodic Consumer Expenditures Surveys (CES) and by the U.S. Department of Housing and Urban Develpopment in its biennial American Housing Surveys (AHS). However, the Consumer Expenditure Survey is the only national survey that provides data both on household expenditures and on demographic characteristics of households. CES data gathered in 1973, 1981, 1985, 1986, and 1987 provide a useful perspective for assessing changes in household expenditure and consumption patterns during the 1970s and 1980s.[7]

Table 1 shows real income and expenditures both per household and per capita for selected CES periods. Differences in levels of and changes in household and per capita income/expenditures illustrates the influence of reduced average household size over the period.

Table 1
REAL HOUSEHOLD EXPENDITURES FOR SELECTED YEARS, 1973 - 1987
(1987 dollars)

Income/Expenditure	1973	1981	1985	1986	1987	% Change 1973-1987
Household Income	$27,244	$24,952	$26,528	$26,411	$27,326	0.3%
Household Expenditures	21,861	21,580	23,458	23,538	24,414	11.7
Shelter Expenditures (% of Income)	11.9%	14.1%	15.3%	15.6%	15.2%	3.3
Fuel & Utilities (% of Income)	3.6	6.3	6.6	6.5	6.1	2.5
Per Capita Income	$9,394	$9,241	$10,202	$10,017	$10,510	11.9
Per Capita Expenditures	7,425	7,891	8,936	8,773	9,390	26.5
Shelter Expenditures (per capita)	1,056	1,399	1,559	1,535	1,598	51.3
Fuel & Utilities Expenditures (per capita)	461	609	669	690	643	39.5

SOURCE: Marc E. Smyrl, Income and Expenditures of Selected Consumer Groups 1973-1985, CRS Report No. 88-318S (Washington, D.C.: Congressional Research Service, The Library of Congress, 1988), Tables I & II, pp. CRS-7 & CRS-9 based on Consumer Expenditure Surveys 1972-73, 1980-81, 1985; "Consumer Expenditure Survey Results from 1986," NEWS, U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C. (April 14, 1988), Table B, p. 3; and "Comprehensive Picture of Consumer Spending Released by Bureau of Labor Statistics," News, U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C. (July 6, 1989), Table B, p. 3.

Decline in household expenditures during the 1970s was not as great as the decline in income and, during the 1980s, expenditures increased more than did income. Hence, real expenditures per household were nearly 12 percent higher in 1987 than they were 14 years earlier, despite real incomes being virtually unchanged. Real expenditures for shelter by householdsincreased by 3.3 percent relative to income and for fuel and utilities by 2.5 percent. This does not necessarily mean, however, that households increased their consumption of housing goods and services; that is, an increased share of income could have been necessary to purchase the same amount of housing in the face of declining real incomes. However, as shown in Table 1, declining incomes account for only part of the increased share of income spent for housing, housing share rising when real income increased during the 1980s as well as when it declined during the 1970s.

The growth in per capita expenditures for shelter and fuel and utilities over the period is much more pronounced. Expenditures in both categories increased some 3 to 4 times as much over the 1973-1987 period as did total household expenditures.

What does this imply? First, the approximately 10 percent smaller typical household in 1987 consumed a substantially larger volume of housing goods and services (some 40 percent to 50 percent larger in per capita terms) than in 1973. Second, this apparently reflected increased preference for housing relative to other goods, services, or savings.

Table 2 shows financial characteristics of three selected groups of households in 1973 and 1985: young households, elderly households, and single-parent households. Because baby-boomers ranged in age from 9 to 27 in 1973 and from 21 to 39 in 1985, comparing characteristics of the typical young household aged 25 to 34 in those years should reflect changes attributable to coming of age of the baby-boom generation.

As with households age 25 to 34, the elderly comprised over one in five U.S. households in 1985, and their proportion is increasing; changes in their expenditure patterns between 1973 and 1985 may be instructive as to future patterns as well. Although single-parent families totaled only slightly over one in twenty U.S. households in 1985, they make up a rapidly growing proportion of the population thought to face special housing finance problems.

Consistent with alternative data sources, young households appear to have suffered a decline in real incomes (nearly 4 percent) between 1973 and 1985, although their per capita incomes increased nearly 14 percent. This apparent anomaly undoubtedly owes in large measure to a nearly 16 percent decrease in the average size of households with heads aged 25 to 34 during this period. At the same time, however, real expenditures for shelter and for fuel and utilities increased by some 44 percent in per capita terms, about the same as for all households. Indeed, average incomes and expenditures for young households differ little from the general population, either in terms of their 1985 levels or in changes occurring during the preceding 12-year period.

Elderly households experienced a larger increase in household income (11.4 percent) than did either of the other two groups discussed here.[8] But they, too, increased their housing expenditures far more than their incomes increased. Consistent with conventional wisdom, the elderly appear to have had much lower incomes in 1985 than did the population as a whole (\$15,836 versus \$25,127 household incomes, and \$8,798 versus \$9,664 per capita incomes).

The elderly also spent a much larger proportion of their 1985 incomes than did the general population (95 percent versus 88 percent), but this represented about an 8 percent increase from 1973 for both groups. Moreover, the elderly spent a substantially larger percent of their per capita incomes for shelter and for fuel and utilities in 1985 than in 1973 (24.8 percent versus 20.0 percent). Again, this mirrors the housing expenditure pattern for the general population in 1985 and 1973 (21.8 percent versus 16.1 percent).

Whereas single-parent households had incomes roughly comparable with those of elderly households in 1985, their income per capita was only about 60 percent as high and the rate of growth only about one-third as great as for the elderly. Single-parent households reported spending more than they earned, per household as well as per capita.[9]

Despite spending less for housing per capita than did the general population, young households, or the elderly, single-parent households spent a far larger percent of their incomes. Indeed, single-parent households spent an average of one-third of their per capita incomes for shelter, fuel, and utilities in 1985. This compares with 27 percent in 1973 and with about 22 percent for the general population in 1985.

CONCLUSION

Several conclusions seem worth noting from the income, expenditure, and housing consumption patterns observed from the Consumer Expenditures Surveys. First, from 1973 to the mid-1980s, all household groups substantially increased their inflation-adjusted expenditures for goods and services generally and for housing services in particular. Second, because of substantial decreases in household size (except for the elderly) during that period, per capita expenditures increased much more than did average household expenditures (again, except for the elderly).

Third, because growth in real incomes was so uneven, in fact decreasing for young households, increased real expenditures posed quite different relative burdens for disparate groups of households. Whereas the typical U.S. household increased its total expenditures as a percent of income from 80 percent to 88 percent between 1973 and 1985, the corresponding increase was from 79 to 86 percent for young households, from 87 percent to 96 percent for the elderly, and from 103 percent to 108 percent for single-parent families. Corresponding increases in household income spent for shelter, fuel, and utilities were from 15 percent to 22 percent for all households, but from 18 percent to 23 percent for young households and from 26 percent to 33 percent for single-parent households.

Fourth, young households' income and expenditure patterns seem to correspond closely with patterns for households generally. Whether this indicates that baby-boomers are emulating other households or vice versa is difficult to say. However, if the pattern continues as

Table 2

REAL INCOME AND EXPENDITURES BY HOUSEHOLD TYPE, 1973 and 1985
(in 1985 dollars)

Income/Expenditures	1985	$ Change 1973-85	% Change 1973-85
YOUNG HOUSEHOLDS[a]			
Household Income	$25,535	-$1,050	- 3.9%
Household Expenditures	21,979	+ 994	+ 4.7
Per Capita Income	9,457	+1,149	+13.8
Per Capita Expenditures	8,140	+1,460	+21.9
For Shelter	1,654	+ 507	+44.2
For Fuel & Utilities	527	+ 162	+44.4
ELDERLY HOUSEHOLDS[b]			
Household Income	15,836	+1,617	+11.4
Household Expenditures	15,132	+2,725	+22.0
Per Capita Income	8,798	+ 434	+ 5.2
Per Capita Expenditures	8,407	+1,109	+15.2
For Shelter	1,338	+ 281	+26.6
For Fuel & Utilities	842	+ 218	+34.9
SINGLE-PARENT HOUSEHOLDS[c]			
Household Income	15,385	+ 575	+ 3.9
Household Expenditures	16,648	+1,400	+ 9.2
Per Capita Income	5,305	+ 677	+14.6
Per Capita Expenditures	5,741	+ 976	+20.5
For Shelter	1,239	+ 303	+32.4
For Fuel & Utilities	523	+ 208	+66.0

[a] Household head or individual aged 25-34.
[b] Household head over age 65.
[c] Household having one parent and children under age 18.

SOURCE: Marc E. Smyrl, Income and Expenditures of Selected Consumer Groups 1973-1985, CRS Report No. 88-318S (Washington, D.C.: Congressional Research Service, The Library of Congress, 1988), Tables VI, VII, X - XIII, pp. CRS-17, CRS-18, CRS-23, CRS-24, CRS-26, & CRS-27 based on Consumer Expenditure Surveys 1972-73, and 1985.

baby-boomers move into middle age, projecting housing demand will be difficult indeed.

Finally, that demographic factors are interrelated is obvious, precisely how they are related less so. Reduced average household size for most segments of the population seems to account for per capita income increases outstripping increases in average household income, despite greatly increased numbers of two-earner households. The usual explanation is that preferences for living alone, for single-parenting, and the like necessarily mean lower average household incomes because of fewer earnings sources. An alternative explanation seems equally plausible, namely, that increased per capita incomes may have enabled many individuals to form smaller households, thereby occasioning increased housing consumption per person. Both relationships undoubtedly exist, but we currently have no way of knowing which predominates. Nevertheless, increasing numbers of small and single-person households which are relatively affluent could increase the demand for smaller, well-appointed homes but it is difficult to say with much certainty.

by
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Mary Schwartz
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1. See, for example, Michael Carliner, "Income distribution and the Housing Industry," Housing Economics, Vol. 37 (December 1988), pp. 4-7.

2. A. home sold for $120,000 in 1981 was about equivalent to one selling for $150,000 in 1987. Existing home sales statlistics are from Existing Home Sales 1985 (Washington, D.C.: NATIONAL ASSOCIATION OF REALTORS®, 1986), Table 1, p.3 and Table 18, p. 16; and Existing Home Sales, 1988 (Wasington, D.C.: NATIONAL ASSOCIATION OF REALTORS®, forthcoming), Table 5.

3. See Michael Carliner, "Income Distribution and the Housing Industry," Housing Economics, Vol. 37 (December 1988), p. 6.

4. See Mary-Lynne François, "Recent Trends in the Size and Amenities of Newly Constructed Housing Units," Real Estate Quarterly, Vol. 5 (Fall 1986).

5. "Characteristics of Housing Completed in 1988," U.S. Department of Commerce and U.S. Department of Housing and Urban Development, Joint Release (March 2, 1989), Table 1.

6. U.S. Department of commerce and U.S. Department of Housing and Urban Development, Current Housing Reports, H-150-85, American Housing Survey for the United States in 1985, (Washington, D.C.: U.S. Government Printing Office, 1988) I, Table 4-13, p. 148 and Table 3-13, p.88.

7. Analysis in this section draws heavily upon Marc E. Smyrl, Income and Expenditures of Selected consumer Groups 1973-1985, CRS Report 88-318 S, Washington, D.C.: Congressional Research Service, The Library of Congress, 1988.

8. This probably owes in part to average size of elderly households increasing from 1.7 persons in 1973 to 1.8 persons in 1985. See Smyrl, Table XII, p. CRS-26.

9. Part of the explanation may be high underreporting of income for this group, e.g., undeclared child-support payments. See, for example, Smyrl, p. CRS-22. However, that underreporting of income by single-parent households is any greater than for say, the elderly, is largely conjectural.

10. U.S. Department of Commerce and U.S. Department of Housing and Urban Development, Current Housing Reports, H-150-85, American Housing Survey for the United States in 1985, (Washington, D.C.: U.S. Government Printing Office, 1988), Table 403, p. 24.

U.S. ECONOMIC OUTLOOK

DECEMBER 1989

	QUARTERS										YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	1989.2	1989.3	89.4	90.1	90.2	90.3	90.4	91.1	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5202	5279	5350	5431	5502	5572	5642	5728	4524	4881	5233	5537	5860
% Change	7.1	6.1	5.5	6.2	5.3	5.2	5.1	6.3	6.9	7.9	7.2	5.8	5.8
% Change (w/out inflation)	2.5	2.7	1.7	1.7	1.4	1.5	1.6	2.3	3.7	4.4	3.0	1.8	2.1
Consumer Price Inflation (CPI)	6.4	2.4	4.0	4.2	3.9	4.2	4.1	4.1	3.7	4.1	4.8	4.0	4.1
GNP Inflation (GNP Deflator)	4.6	3.2	4.0	4.5	3.8	3.7	3.6	4.0	3.1	3.3	4.2	3.9	3.7
Unemployment Rate - Civilian	5.3	5.2	5.4	5.5	5.6	5.6	5.7	5.7	6.2	5.5	5.3	5.5	5.6
Civilian Employment-Household Basis (millions)	117.3	117.5	117.7	117.9	118.2	118.4	118.6	118.9	112.4	115.0	117.3	118.3	119.4
Percent change	1.3	0.7	0.5	1.0	0.8	0.8	0.7	0.9	2.6	2.3	2.1	0.8	1.0
Index of Industrial Production	141.8	142.2	141.8	142.1	142.0	142.9	143.6	145.4	129.8	137.2	141.8	143.9	146.8
Manufacturing Capacity Utilization	84.4	83.9	82.8	82.7	82.4	82.6	82.9	83.5	81.0	83.6	84.1	83.6	83.6
Domestic Auto Sales	7.3	7.9	6.2	6.6	6.9	7.0	6.8	7.0	7.1	7.5	7.2	6.8	7.0
Federal Tax Receipts (NIPA) as % of GNP	20.2	19.7	19.7	20.4	20.5	20.5	20.5	20.5	20.1	19.9	20.0	20.5	20.5
Federal Expenditures (NIPA) as % of GNP	23.0	22.6	22.7	22.7	22.6	22.6	22.5	22.7	23.7	22.9	22.9	22.6	22.5
Deficit(NIPA)	-145.4	-149.4	-147.8	-125.3	-118.2	-118.7	-117.3	-125.6	-161.3	-145.9	-150.7	-119.9	-121.8
as % of GNP	-2.8	-2.8	-2.8	-2.3	-2.1	-2.1	-2.1	-2.2	-3.6	-3.0	-2.9	-2.2	-2.1
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4286	4405	4376	4278	4383	4433	4402	4410	4633	4650	4395	4374	4443
Percent change -- year ago	-8.2	-6.1	-10.2	-5.2	2.3	-0.3	1.0	3.1	-1.6	0.3	-5.5	-0.5	1.6
Existing Single-family Home Sales (thousands)	3323	3443	3385	3245	3339	3404	3389	3408	3512	3594	3407	3345	3450
Percent change -- year ago	-8.8	-6.0	-10.2	-6.7	0.5	-1.1	0.1	5.0	-1.4	2.3	-5.2	-1.8	3.2
Housing Starts (thousands)	1352	1339	1402	1452	1466	1460	1448	1444	1634	1495	1428	1457	1435
Percent change -- year ago	-8.4	-8.8	-9.8	-4.3	8.4	9.1	3.3	-0.5	-9.8	-8.5	-4.5	2.0	-1.5
Single-Family Units	993	992	1022	1065	1076	1061	1044	1034	1156	1088	1019	1061	1024
Percent change -- year ago	-6.2	-6.1	-8.9	-0.4	8.4	6.9	2.1	-3.0	-2.2	-5.9	-6.4	4.2	-3.5
Multi-Family Units	360	346	380	387	390	400	405	411	477	407	384	395	411
2-4 Family Units	53	57	60	61	61	63	64	65	65	59	57	62	65
Percent change -- year ago	-8.1	-5.8	-11.2	2.3	15.4	10.0	5.8	6.2	-23.0	-9.5	-3.4	8.8	4.0
5 + Family Units	307	289	320	326	329	337	341	346	412	348	326	333	347
Percent change -- year ago	-15.0	-17.4	-12.2	-16.1	7.1	16.6	6.7	6.2	-24.4	-15.6	-6.2	2.2	4.0
New Single-family Home Sales (thousands)	636	705	635	546	577	610	588	616	673	677	650	580	649
HOME PRICES													
Existing Home Prices - Median $(1000)	93.0	95.3	94.5	96.2	97.9	100.2	99.7	101.4	84.9	88.9	93.5	98.5	103.4
Percent change -- year ago	4.6	5.7	6.6	5.4	5.3	5.2	5.5	5.4	5.8	4.7	5.2	5.3	5.0
New Home Prices - Median $(1000)	119.5	120.1	125.0	123.4	126.3	127.3	128.4	129.7	104.7	113.9	120.7	126.3	133.1
Percent change -- year ago	5.8	4.5	8.9	4.6	5.7	6.0	2.7	5.1	13.5	8.8	6.0	4.7	5.4
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year Fixed Rate Mortgage (FHA Secondary)	10.5	9.8	9.8	9.6	9.4	9.4	9.5	9.7	10.2	10.5	10.3	9.5	9.8
1-year ARM (effective rate)	9.7	9.7	9.5	9.2	9.0	9.0	9.1	9.2	8.5	8.5	9.7	9.1	9.3
Corporate AAA Bond Rate	9.5	9.0	8.8	8.6	8.4	8.4	8.5	8.5	9.4	9.7	9.2	8.5	8.8
Government Bond Rate	8.7	8.1	7.9	7.7	7.5	7.5	7.6	7.8	8.6	9.0	8.4	7.6	8.0
Short-Term Interest Rates													
Federal Funds Rate	9.7	9.1	8.6	8.3	8.0	8.1	8.2	8.4	6.7	7.6	9.2	8.2	8.4
3-month T-Bill Rate	8.4	7.8	7.6	7.3	7.0	7.2	7.2	7.4	5.8	6.7	8.1	7.2	7.4
Prime Rate	11.4	10.7	10.3	10.0	9.8	9.8	9.7	9.7	8.2	9.3	10.8	9.8	9.8
Discount Rate	7.0	7.0	7.0	7.0	6.7	6.5	6.5	6.5	5.7	6.2	6.9	6.7	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	100.4	100.5	97.9	96.2	93.9	91.8	90.4	89.7	96.9	92.8	98.7	93.1	89.9
Percent change	19.7	0.4	-9.8	-6.9	-9.3	-8.5	-5.8	-3.0	-13.6	-4.3	6.4	-5.7	-3.5

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

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REAL ESTATE OUTLOOK

Vol. 3, No. 1

January 1990

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The Commerce Department made its final revision to third quarter real GNP growth, raising the estimate 0.3 percentage points, on top of last month's 0.2 percentage point revision, to a final estimate of 3.0 percent. Despite the string of upward adjustments, the fourth quarter real GNP number is not likely to be nearly as strong, as growth in virtually every sector of the economy has slowed markedly.

- With the economy apparently at a virtual standstill, the Federal Reserve is expected to continue to allow short-term interest rates to slide through the first half of this year. Interest rates are likely headed down at both ends of the yield curve. As the Fed continues to ease credit during the opening months of the new year, the economy is expected to gradually return to near-trend growth, followed closely by a firming up in rates.

- Private housing starts fell in November to a seasonally adjusted annual rate of 1.361 million units, down 4.7 percent from their October annual rate of 1.428 million units. Despite the November slip, single-family housing starts may be poised for further advances in early 1990, due to lower interest rates.

- Sales of existing single-family homes reached a seasonally adjusted annual rate of 3.59 million units in November, up 3.2 percent from the October annual rate of 3.48 million units. The November rate of 3.59 million homes marks the fastest monthly sales rate during all of 1989. Existing home sales appear to be benefiting substantially from the slide in mortgage interest rates.

IN THIS ISSUE

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AND THE WALLS CAME TUMBLIN' DOWN

Economic Commentary

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

January is a clean slate; the year forward will always be one in which we correct our faults, mend our relationships and finally make that big deal. This January is even more special because it's the beginning of a decade, and we look a little bit farther down the road than we normally do. Economists, too, are swept up in that tide of optimism and sometimes see the rosy future that usually eludes their gaze.

Such is the case with the recent events in Eastern Europe. The tide of democracy that has swept over those recently bleak shores has surfaced a great many questions about what impact will reach these shores. In fact, they have managed to wake up many Americans to the "news" that Western Europe is in the process of building an economic superpower that will rival anything that the U.S. or the Pacific Basin will offer. Now, what if the two Europes can join forces?

Oddly enough, I think the political and economic changes that are occurring in the Soviet Bloc will, on balance, bring good news to the American economy. But it won't be an unmixed blessing.

Clearly, the biggest benefit we can derive from the opening of the East is the redirection or reduction of our defense establishment. The crying need for real investment in housing, education, health care, technological development and infrastructure that exists in this country will be well served by either a devotion of current Federal spending to those purposes or a reduction in interest rates caused by a fall in the Federal deficit.

But that redirection will have major impacts on those metropolitan areas which have built their economies around military spending. These range from areas with large military populations (which will be the first to be affected) to research centers. Moreover, if the Soviets can successfully redirect spending and realize the agricultural potential of their own economy, U.S. grain exports will suffer, and the farm economy with them. Should we see the reduction in military spending by both superpowers that is so widely forecast, the early part of the Nineties will see some painful adjustments in these areas.

To some extent, the adjustment process may well be made easier by the general economic benefits that will flow from a permanent detente. With or without a reduction in Federal borrowing, interest rates are headed lower in the Nineties because of a growing Social Security trust fund and the aging of the baby boom generation. If, in addition, the deficit falls dramatically (a five percent cut in military spending shaves $15-20 billion from Federal borrowing), interest rates plunge. This begins to make feasible the kinds of investment in technology that we need to restore our international competitiveness.

And if (to be cynical for a moment) the government finds that it must continue to spend money at the same level, the reduction in military necessity can fund new programs in housing, upgrades in our educational system, repairs to our roads and bridges, and the creation of new hospitals and clinics. This also sets the stage for a more competitive America.

All this suggests a scenario that is very un-economist. Falling interest rates combine with reduced and redirected Federal spending to adapt U.S. production processes to state-of-the-art technology and places the economy on a stable growth path. An improved educational system feeds the production process and enables us to meet, and exceed the economic challenges of a united Europe, a revitalized Soviet Union and a fully-developed Pacific rim. These are augmented by a health care system that accommodates a growing body of elderly, and a housing system that provides access at all income levels.

The rosy scenario has long been a staple of Washington life. Administrations present and past have hung their forecasts and their reputations on the contention that things will be better. So there are clearly other alternatives. In fact, if the Chicken Littles who have been assaulting the housing sector of late had their way, we'd all be headed for a major crisis of uncertainty about survival and prosperity. Why? Because the expansion has gone on too long, not because the fundamentals of the economy point that way. America has long been imbued with a blue-stocking fear that somewhere, someone was having fun and that person ought to be caught and stopped.

Will the Golden Age described above come about? The probabilities are less than 50 percent. But the good news is that they are higher now than they were six months ago. At the battle of Jericho, Joshua marched around the city seven times and ordered the Israelites to blow their trumpets. The walls came down and the way to the Promised Land was opened. Now the trumpets of democracy have sounded and another wall has fallen. And the result may be another opening to another garden.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The Commerce Department made its final revision to third quarter real GNP growth, raising the estimate 0.3 percentage points on top of last month's 0.2 percentage point revision, to a final estimate of 3.0 percent. Despite the string of upward adjustments, the fourth quarter real GNP number is not likely to be nearly as strong, as growth in virtually every sector of the economy has slowed markedly. The news from several closely watched monthly indicators has not been good, and suggests the economy is advancing at an annual rate of only about 1.0 percent. This is well below the trend rate of growth of 2.5 percent, and means the risk of a recession has increased. However, the Federal Reserve has been responding to these signs of slower growth by loosening its grip on credit, and allowing interest rates to slide moderately lower. Our forecast remains one of cautious optimism: while we cannot rule out perhaps one quarter of negative growth, we still expect the economy to avoid a recession. Further, we expect the economy to quickly emerge from this brief slowdown and return to a trend rate of growth of near 2.5 percent later this year.

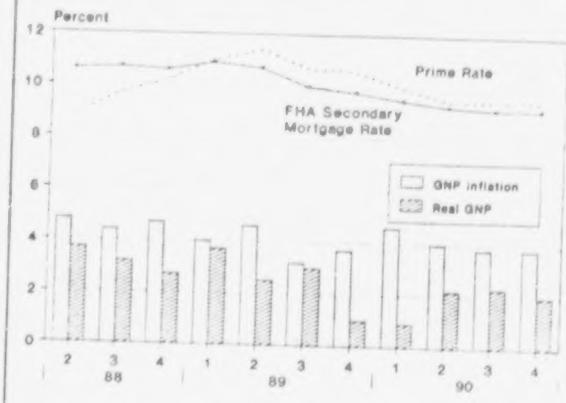
Employment Growth Remains Spotty

The report on December employment is the most recent indicator of a slowing economy, although its true meaning was clouded by a number of technical factors. The civilian unemployment rate remained unchanged at 5.3% during December, as both the labor force and household employment advanced by about 50,000. However, the December rise of 142,000 was helped by 55,000 workers returning from strikes, and was hurt by severe winter weather that trimmed construction employment by 38,000. Overall, the economy generated 2.5 million new jobs in 1989, and maintained a very stable rate of unemployment. Still, there have been some important trends emerging in the employment situation over the past year. Factories have laid off 195,000 workers since March, and even service-sector employment has had its reputation as the engine of job generation tarnished. Most of the recent growth in service employment continues to come from the health sector, instead of from business services which advanced by only 140,000 jobs in 1989 (compared to annual employment growth of 300,000-500,000 jobs during the opening six years of the current expansion).

Consumers Adjust Plans

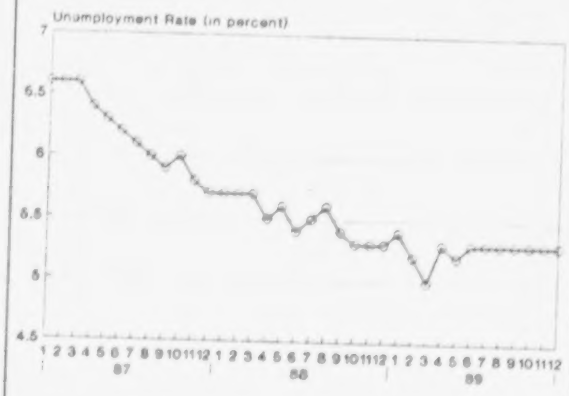
Uncertainty regarding the economy has also crept into data on consumer confidence. According to the Conference Board, the December consumer confidence index declined to 113.1, down almost four percent since October. The index was markedly lower than the 119.4 reading of December 1988. The Conference Board says that the level of consumer confidence remains high. Still, the opinions of the 5,000 households surveyed during the first two weeks of December reflect less confidence in general business conditions, and more modest spending plans. In December 1989, 25.1% of those surveyed called business conditions "good," compared to 32.5% in December 1988. In December 1989, fewer respondents said they had plans to buy a house, car, or major appliance in the near future, than during the December 1988 survey.

GRAPH 1: THE ECONOMIC OUTLOOK



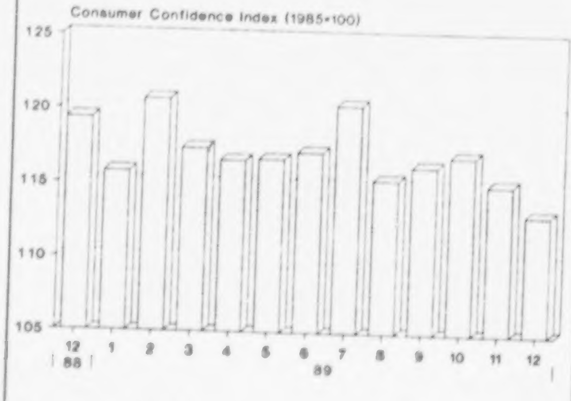
Source: Bureau of Economic Analysis; E NAR estimates

GRAPH 2: UNEMPLOYMENT STAYS FLAT



Source: Bureau of Labor Statistics

GRAPH 3: CONSUMER CONFIDENCE WAVERS



Source: Conference Board

Mean Winters Can Mean Nasty Inflation

Despite any signs of a slowdown, consumer price inflation continued to advance at a rate of 4.7% for the twelve months ending in November 1989. The November monthly rise in the index of 0.4% was a bit higher than was expected, and came directly on the heels of a 0.5% monthly advance in October. Further, the November increase came despite declines in energy prices and transportation and clothing costs. The strength of the November price increases were focused in the medical and food components. Medical costs surged 0.8% in November, and have advanced 8.5% over the last 12 months. Food price increases were powered by sizable jumps in dairy prices. Producer prices declined in November for the third time in five months, lending some confusion to the inflation debate. It appears, however, that inflation worries are far from easing, particularly with the cold winter months expected to send tremors through the energy components of the price indices during the December-February period. The adequacy of seasonal factors aside, the core rate of inflation still seems to be about 4.25%.

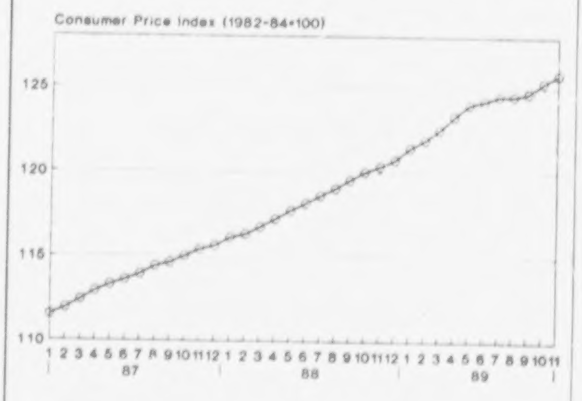
Public, Residential Construction Spending Up

Construction spending rose to a seasonally adjusted annual rate of $421.7 billion in November, up from a revised $415.6 billion reported for October. Spending on both public construction and private residential construction contributed to the gain. The largest single contributor to the November rise was a 7% advance in spending for public construction projects to an annual rate of $91.4 million, which was nearly 11% above the November 1988 rate. Private residential construction spending increased by 0.6% in November to an annual rate of $194.4 million. However, private residential construction spending remained well below its November 1988 spending pace of $202 million. Non-residential construction spending fell by 0.7% in November to an annual rate of $100.7 billion, but it remained nearly 5% above its November 1988 rate.

With Economy Flat, Rates Are Headed Down

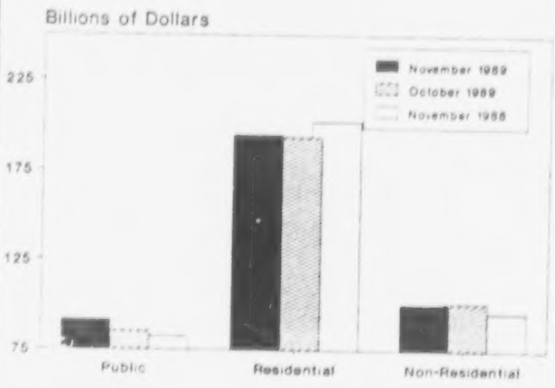
With the economy apparently at a virtual standstill, the Federal Reserve is expected to continue to allow short-term interest rates to slide through the first half of this year. This is not to say that the Fed has abandoned its longstanding battle with inflation; the Fed will resume its fight with inflation around mid-year as signs emerge of a resurgence in economic growth. Until then, interest rates are likely headed down at both ends of the yield curve. In fact, most major banks just lowered the prime rate to 10%, the first cut in this symbolic rate since July 31, 1989. This rate cut will reduce interest rates on a wide range of adjustable rate consumer loans, including home-equity loans, car loans, and lines of credit. However, this is not expected to have a broad impact on the economy as consumer credit levels are still very high. In addition, recent revelations about loan losses in real estate and other areas, has led many banks to adopt more conservative lending practices. But as the Fed continues to ease credit during the opening months of the new year, the economy is expected to gradually return to near-trend growth, followed closely by a firming up in rates.

GRAPH 4: CONSUMER PRICES STILL RISING



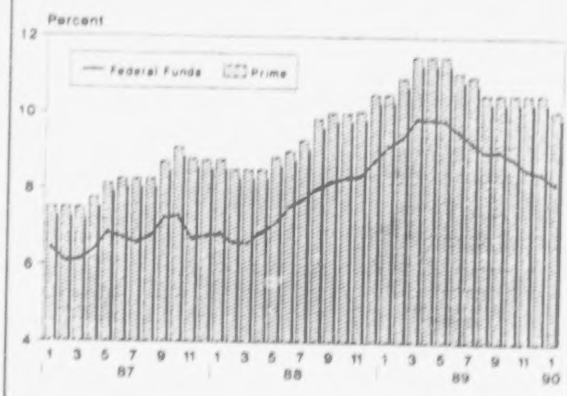
Source: Bureau of Labor Statistics

GRAPH 5: CONSTRUCTION SPENDING UP



Source: Dept. of Commerce

GRAPH 6: FED FUNDS, PRIME RATE DROP



Source: Federal Reserve

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

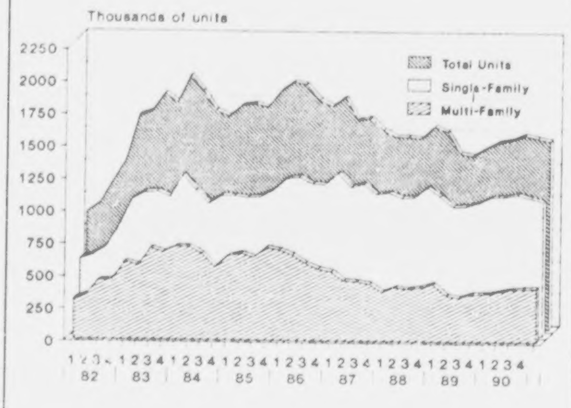
	Total	S-F	2-4	5 and up
Nov 1989	1361	1015	51	295
Oct 1989	1428	1024	61	343
Sep 1989	1264	971	57	236
Aug 1989	1329	990	56	283
Jul 1989	1420	1026	57	337
Nov 1988	1567	1138	68	361
Nov 1989 Changes From (%):				
Oct 1989	-4.7	-0.9	-16.4	-14.0
Nov 1988	-13.1	-10.8	-25.0	-18.3

REGIONAL DATA

	Northeast	Midwest	South	West
Nov 1989	186	305	495	375
Oct 1989	180	294	558	396
Sep 1989	161	248	486	369
Aug 1989	140	236	563	390
Jul 1989	189	274	531	426
Nov 1988	219	275	613	460
Nov 1989 Changes From (%):				
Oct 1989	3.3	3.7	-11.3	-5.3
Nov 1988	-15.1	10.9	-19.2	-18.5

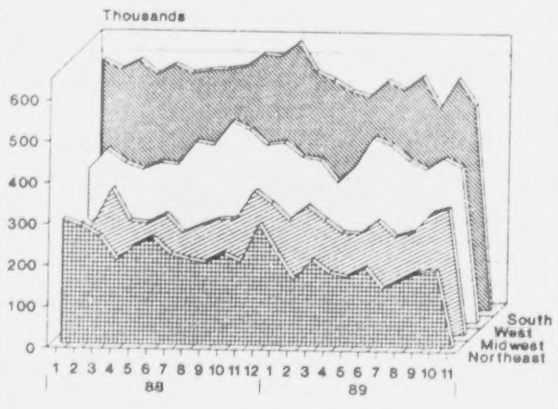
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Private housing starts fell in November to a seasonally adjusted annual rate of 1.361 million units, down 4.7 percent from their October annual rate of 1.428 million units. However, this decline comes immediately following a gain in new housing construction of 13% during October. Most of the weakness was centered in multi-family starts: starts of 2-4 units fell 16.4%, while starts of 5+ units fell 14.0%. Starts of single-family units fell only 0.9% from 1.024 million units in October, to 1.015 million units in November. Single-family starts activity was 10.8% slower than the November 1988 annual rate of 1.138 million units. Despite the November slip, single-family housing starts may be poised for further advances in early 1990, as lower interest rates brought about by the Fed's loosening will encourage some resurgence in housing construction.

By region, the Northeast and Midwest posted their third consecutive monthly advances, while starts slowed in the South and the West. In the Northeast, starts reached an annual rate of 186 thousand units, up 3.3% from October, but 15.1% below November 1988. In the Midwest, starts advanced to an annual rate of 305 thousand units, 3.7% faster than October, and 10.9% above the November 1988 pace. After rising nearly 15% in October, starts in the South fell 11.3% in November, and were 19.3% below the November 1988 rate. Starts in the West slipped 5.3 percent in November, after climbing 7.3% in October, and they were 18.5% below a year ago.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Nov 1989	710	Apr 1989	607
Oct 1989	648	Mar 1989	555
Sep 1989	642	Feb 1989	621
Aug 1989	723	Jan 1989	700
Jul 1989	738	Dec 1988	669
Jun 1989	647	Nov 1988	650
May 1989	653		

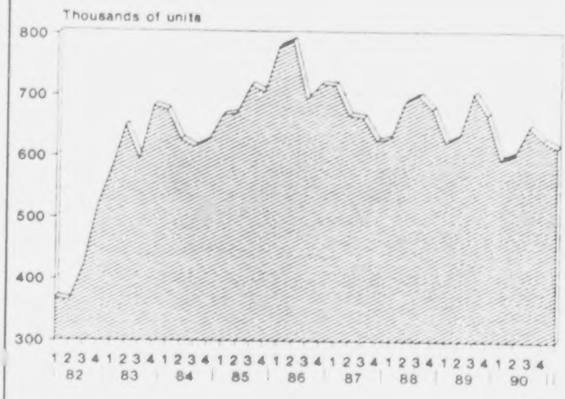
Nov 1989 Changes From:		Annual Totals:	
Oct 1989	9.6	1987	671
Nov 1988	9.2	1988	676

REGIONAL DATA

	Northeast	Midwest	South	West
Nov 1989	102	136	256	217
Oct 1989	94	110	277	167
Sep 1989	62	106	262	213
Aug 1989	90	101	294	239
Jul 1989	99	127	282	229
Jun 1989	73	99	259	215
Nov 1988	65	104	254	227
1988	102	97	276	202
1987	117	97	271	186
Nov 1989 Changes From:				
Oct 1989	8.5	23.6	-7.6	29.9
Nov 1988	56.9	30.8	0.8	-4.4

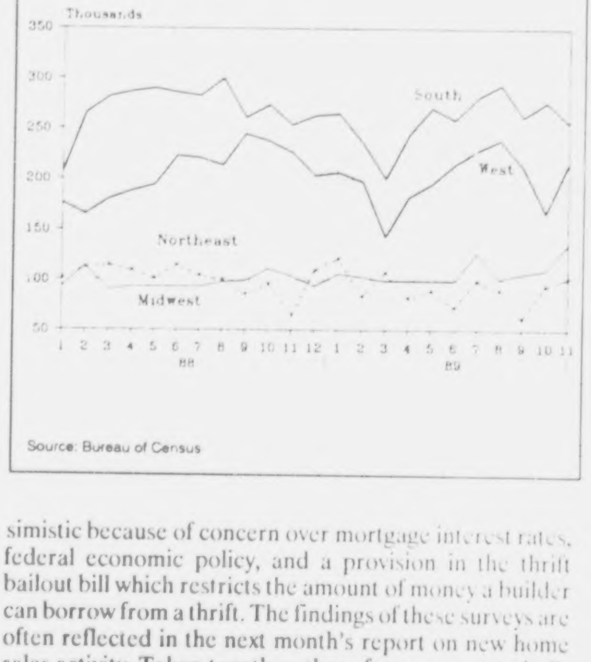
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

Sales of new single-family homes unexpectedly surged in November to an annual rate of 710 thousand homes, up 9.6% from the October annual rate of 648 thousand homes, and up 9.2% from the November 1988 pace of 650 thousand homes. The principal cause for the sudden strength in new home sales, appears to have been the availability of single-digit fixed rate mortgages. However, according to a monthly builder survey by the National Assn. of Homebuilders, builders are more pessimistic about the outlook for new housing in 1990, than they have been at any time in the past seven years. Results from the December report identified 41% of the builders surveyed as saying their expectations for sales were poor, up from 38% in November. Builders said they had become pessimistic because of concern over mortgage interest rates, federal economic policy, and a provision in the thrift bailout bill which restricts the amount of money a builder can borrow from a thrift. The findings of these surveys are often reflected in the next month's report on new home sales activity. Taken together, these factors seem to indicate that the unexpected surge in November sales was not the beginning of a full-scale rebound in housing. However, continued easing of credit by the Fed is expected to have a growing positive impact on housing market activity in the coming months.

By region, the annual rate of new single-family home sales increased 8.5% in the Northeast, 23.6% in the Midwest, and 29.9% in the West, but fell 7.6% in the South.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Nov	1989	3590	Apr	1989	3400
Oct	1989	3480	Mar	1989	3400
Sep	1989	3520	Feb	1989	3480
Aug	1989	3480	Jan	1989	3550
Jul	1989	3330	Dec	1988	3920
Jun	1989	3360	Nov	1988	3710
May	1989	3210			

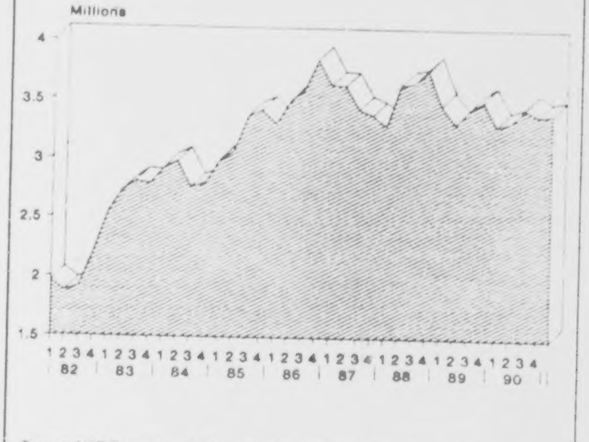
Nov 1989 Changes From (%):			Annual Totals:	
Oct	1989	3.2	1988	3594
Nov	1988	-3.2	1987	3526

REGIONAL DATA

		Northeast	Midwest	South	West
Nov	1989	590	950	1420	640
Oct	1989	580	990	1300	620
Sep	1989	590	990	1340	590
Aug	1989	590	980	1350	550
Jul	1989	550	910	1300	570
Jun	1989	510	960	1280	600
Nov	1988	680	940	1410	680
	1988	673	929	1350	642
	1987	685	959	1282	600
Nov 1989 Changes From (%):					
Oct	1989	1.7	-4.0	9.2	3.2
Nov	1988	-13.2	1.1	0.7	-5.9

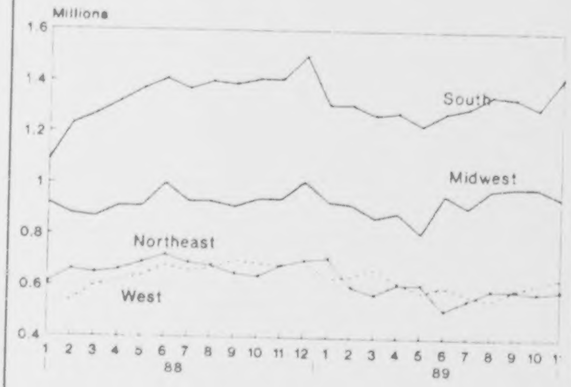
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

Sales of existing single-family homes reached a seasonally adjusted annual rate of 3.59 million units in November, up 3.2 percent from the October annual rate of 3.48 million units. The November rate of 3.59 million homes marks the fastest monthly sales rate during all of 1989. Still, the November pace was 3.2 percent slower than the 3.71 million unit annual rate of November 1988. Existing home sales appear to be benefiting substantially from the slide in mortgage interest rates that is expected to continue on into the third quarter of 1990. Lower mortgage rates also helped to improve housing affordability slightly in November. The NAR housing affordability index, which tracks monthly changes in homebuyers' purchasing power, climbed to 105.8 percent from 105.5 percent in October. This means, a family earning the national median income of $33,482 for November, had 105.8 percent of the income necessary to qualify for an 80% mortgage on an existing home priced at the national median of $93,000.

By region, existing single-family home sales rose in all regions except the Midwest. In that region, home sales dropped 4.0% in November, but remained 1.1% above November 1988. In the Northeast, home sales rose 1.8%, but were 13.2% below their November 1988 pace. In the South, home sales rose 9.2% to an annual rate of 1.42 million units, and were 0.8% above their year ago rate. In the West, home sales increased 3.2%, but slipped 5.9% below their year ago pace.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

	Median Existing	Median New	Average Existing	Average New
Nov 1989	93,000	127,000	118,300	155,900
Oct 1989	92,600	123,000	117,200	147,600
Sep 1989	94,300	119,000	118,400	149,700
Aug 1989	94,800	122,900	120,800	158,600
Jul 1989	96,700	116,000	122,100	140,300
Nov 1988	88,500	110,400	112,400	137,300
1988	89,300	112,500	112,800	138,300
1987	85,600	104,500	106,300	127,200
Nov 1989 Changes From (%):				
Oct 1989	0.4	3.3	0.9	5.6
Nov 1988	5.1	15.0	5.2	13.5

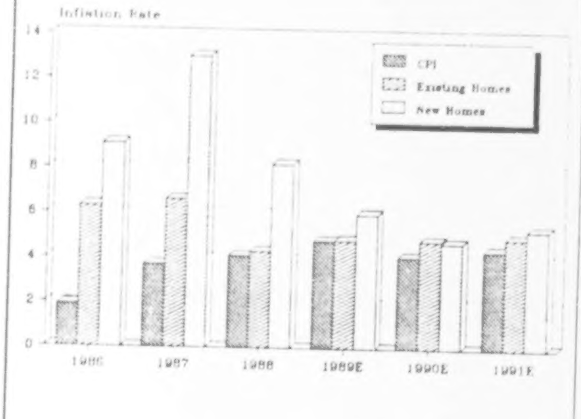
REGIONAL DATA

	Northeast	Midwest	South	West
Nov 1989	145,800	70,900	82,400	150,200
Oct 1989	143,200	71,600	83,600	142,300
Sep 1989	145,700	72,200	84,400	147,600
Aug 1989	149,000	71,900	86,100	147,500
Jul 1989	147,100	73,400	87,200	146,500
Nov 1988	140,700	67,400	80,400	130,900
1988	143,000	68,400	82,200	124,900
1987	133,300	66,000	80,400	113,200
Nov 1989 Changes From (%):				
Oct 1989	1.8	-1.0	-1.4	5.6
Nov 1988	3.6	5.2	2.5	14.7

Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

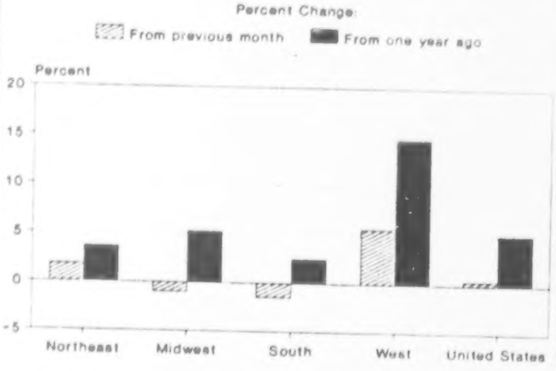
The median sales price of an existing single-family home rose modestly in November to $93,000, an increase of 0.4% from the October median price of $92,600. The November increase brought the 12 month advance in the median existing single-family home price to 5.1% from the November 1988 median price of $88,500. In the Northeast, the median price rose 1.8% in November, and was up 3.6% over the last 12 months. In the Midwest, the median price fell 1.0% in November, but was up 5.2% over the last 12 months. In the South, the median price fell 1.4% in November, and was up only 2.5% in the past 12 months. In the West, the median price shot up 5.6% in November alone to $150,200, which is 14.7% above the November 1988 median price of $130,900.

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The median sales price of a new single-family home reached $127,000 in November, an increase of 3.3% from the October median price of $123,000. The November median price was 15% higher than the November 1988 median price for a new single-family home. However, new home prices are prone to wild fluctuations. For example, the November 1989 median price is only 5.0% higher than the December 1988 median price of $121,000.

Sean A. Burns
Director of Forecasting
Forecasting & Policy Analysis Division

U.S. ECONOMIC OUTLOOK

JANUARY 1990

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	1989.2	1989.3	89.4	90.1	90.2	90.3	90.4	91.1	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5202	5281	5344	5417	5501	5584	5663	5755	4524	4881	5235	5541	5894
% Change	7.1	6.2	4.9	5.5	6.3	6.2	5.8	6.7	6.9	7.9	7.3	5.8	6.4
% Change (w/out inflation)	2.5	3.0	1.0	0.9	2.2	2.3	2.0	2.3	3.7	4.4	3.0	1.8	2.3
Consumer Price Inflation (CPI)	6.4	2.4	4.0	4.3	4.0	4.3	4.3	4.4	3.7	4.1	4.8	4.1	4.4
GNP Inflation (GNP Deflator)	4.6	3.2	3.7	4.6	4.0	3.8	3.8	4.2	3.1	3.3	4.2	4.0	4.0
Unemployment Rate - Civilian	5.3	5.2	5.4	5.5	5.6	5.6	5.6	5.6	6.2	5.5	5.3	5.6	5.6
Civilian Employment-Household Basis (millions)	117.3	117.5	117.7	117.9	118.1	118.4	118.7	119.0	112.4	115.0	117.4	118.3	119.6
Percent change	1.3	0.7	0.8	0.5	0.8	1.0	1.0	1.0	2.6	2.3	2.1	0.8	1.1
Index of Industrial Production	141.8	142.2	141.9	142.2	142.5	143.4	144.2	144.9	129.8	137.2	141.6	143.1	146.3
Manufacturing Capacity Utilization	84.4	84.0	82.9	82.7	82.3	82.6	82.8	82.8	81.0	83.5	83.9	82.6	82.9
Domestic Auto Sales	7.3	7.9	6.0	6.5	6.6	6.3	6.8	7.0	7.1	7.5	7.0	6.7	7.0
Federal Tax Receipts (NIPA) as % of GNP	20.2	19.8	19.9	20.4	20.5	20.5	20.5	20.5	20.1	19.9	20.0	20.4	20.5
Federal Expenditures (NIPA) as % of GNP	23.0	22.5	22.6	22.7	22.6	22.5	22.4	22.5	23.7	22.9	22.8	22.6	22.3
Deficit(NIPA)	-145.0	-144.0	-148.0	-127.0	-118.0	-114.0	-108.0	-113.0	-161.0	-145.0	-146.0	-117.0	-105.0
as % of GNP	-2.8	-2.7	-2.8	-2.3	-2.2	-2.0	-1.9	-2.0	-3.6	-3.0	-2.8	-2.1	-1.8
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4285	4408	4507	4340	4379	4512	4419	4413	4633	4649	4429	4413	4440
Percent change -- year ago	-8.2	-6.0	-7.5	-3.8	2.2	2.4	-2.0	1.7	-1.6	0.3	-4.7	-0.4	0.6
Existing Single-family Home Sales (thousands)	3323	3443	3516	3305	3339	3455	3389	3408	3512	3594	3440	3372	3450
Percent change -- year ago	-8.8	-6.0	-6.7	-5.0	0.5	0.3	-3.6	3.1	-1.4	2.3	-4.3	-2.0	2.3
Housing Starts (thousands)	1352	1337	1393	1440	1460	1497	1474	1454	1633	1494	1400	1468	1437
Percent change -- year ago	-8.4	-8.8	-10.6	-5.1	8.0	11.9	5.9	1.0	-9.8	-8.5	-6.3	4.9	-2.1
Single-Family Units	992	995	1022	1067	1072	1090	1061	1036	1156	1088	1020	1073	1020
Percent change -- year ago	-6.2	-6.1	-10.2	-0.2	8.0	9.5	3.8	-2.9	-2.2	-5.9	-6.3	5.2	-4.9
Multi-Family Units	359	342	370	372	388	406	413	417	477	406	380	395	417
2-4 Family Units	53	56	61	61	64	67	68	69	65	59	57	65	69
Percent change -- year ago	-8.1	-0.6	-6.0	4.1	21.3	19.0	11.4	12.1	-23.0	-9.5	-2.4	13.7	5.5
5 + Family Units	306	285	309	310	323	339	344	348	412	347	322	329	347
Percent change -- year ago	-15.0	-18.2	-12.9	-19.9	5.6	19.0	11.4	12.1	-24.4	-15.6	-7.2	2.3	5.5
New Single-family Home Sales (thousands)	636	705	669	597	607	651	629	616	673	677	659	621	649
Percent change -- year ago	-8.8	0.3	-1.9	-12.7	-4.6	-7.7	-6.0	3.2	-9.6	0.5	-2.6	-5.8	4.5
Mobile Homes Shipped (thousands)	201	185	178	177	180	182	181	181	232	217	195	180	182
HOME PRICES													
Existing Home Prices - Median $(1000)	93.0	95.3	93.2	94.6	97.0	99.5	99.7	101.4	84.9	88.9	93.2	97.7	103.4
Percent change -- year ago	4.6	5.7	6.6	5.4	5.3	4.4	5.5	5.4	5.8	4.7	4.8	4.8	5.0
New Home Prices - Median $(1000)	119.5	120.1	125.0	123.4	125.8	128.0	128.4	129.7	104.7	113.9	120.7	126.4	133.1
Percent change -- year ago	5.8	4.5	8.9	4.6	5.7	6.6	2.7	5.1	13.5	8.8	6.0	4.7	5.3
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year Fixed Rate Mortgage (FHA Secondary)	10.7	10.0	9.8	9.5	9.3	9.2	9.2	9.4	10.2	10.3	10.3	9.3	9.5
1-year ARM (effective rate)	9.7	9.3	8.8	8.6	8.5	8.4	8.4	8.5	8.5	8.5	9.3	8.5	8.6
Corporate AAA Bond Rate	9.5	9.0	8.9	8.6	8.5	8.3	8.3	8.4	9.4	9.7	9.3	8.4	8.6
Government Bond Rate	8.7	8.1	7.9	7.7	7.5	7.4	7.4	7.5	8.6	9.0	8.4	7.5	7.7
Short-Term Interest Rates													
Federal Funds Rate	9.7	9.1	8.7	8.1	7.7	7.7	7.7	7.9	6.7	7.6	9.2	7.8	8.0
3-month T-Bill Rate	8.4	7.8	7.7	7.2	6.9	6.9	6.9	7.0	5.8	6.7	8.1	7.0	7.1
Prime Rate	11.4	10.7	10.6	10.0	9.5	9.5	9.5	9.5	8.2	9.3	10.9	9.6	9.7
Discount Rate	7.0	7.0	7.0	6.6	6.5	6.5	6.5	6.5	5.7	6.2	6.9	6.5	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	100.4	100.5	97.3	93.0	92.4	90.3	89.1	88.6	96.9	92.8	98.5	91.2	88.9
Percent change	19.7	0.4	-12.1	-16.5	-2.6	-8.7	-5.3	-2.2	-13.6	-4.3	6.2	-7.4	-2.6

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy. Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE

Vol. 3, No. 2

OUTLOOK

February 1990

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce estimates that the economy continued to grow in the fourth quarter, but at the very slow inflation-adjusted annual rate of 0.5 percent. A silver lining in the GNP report was that the slower growth has helped cool the rate of inflation: the implicit price deflator, a broad index of inflation in the economy, rose at only a 3.5 percent annual rate.
- However, prices at the producer level surged 1.8 percent in January, equivalent to an annual rate of 23.9 percent. This was the largest monthly gain in fifteen years. But after adjustments for large increases in food and energy prices, the increase in January producer prices was a scant 0.1 percent, or 1.2 percent at an annual rate.
- Housing starts dropped 8.0% in December to a seasonally adjusted annual rate of 1.235 million units. The December 1989 pace was 21.7% below the December 1988 annual rate of 1.577 million units. Starts of single-family units during December 1989 fell to an annual rate of 904 thousand units, down 20.8% from December 1988.
- Sales of new single-family homes fell back in December to an annual rate of 629 thousand units, 9.6 percent below their November pace of 696 thousand units. New home sales also lagged 6.0 percent behind the December 1988 annual sales rate of 669 thousand units.
- Sales of existing single-family homes slipped 1.1 percent in December to an annual rate of 3.55 million homes. The December 1989 pace was 9.4 percent slower than the December 1988 annual rate of 3.92 million units. During all of 1989, 3.43 million existing single-family homes were sold.

IN THIS ISSUE

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The Beasts of Winter:
Economic Commentary

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

Bears are supposed to hibernate during the winter. Not this year. The financial press has kept up an incessant mewl of pessimistic drivel that has compounded the already significant disorder of our financial system. Hey, folks, we all know that when the weather turns exceptionally cold (c.f. December 1989), produce freezes and oil consumption rises. Markets (and middlemen) being what they are, prices will then rise. And we all know that the arcane way public numbers are reported (a.k.a. seasonally adjusted annual rates) ensure that December and January figures are usually well out of line with reality. Yet increases in the rate of inflation are taken as signs that the economy is expanding again and used as a pretext for rising interest rates.

This anomaly can be explained by two reasons. First, it pays to be pessimistic: if you're right, you gain great respect; if you're wrong, everyone is too happy to remember your prediction. Being optimistic is lose-lose, for the opposite reasons. Thus many economists and financial writers have enjoyed comfortable careers imitating Joe Btfsplk, the character in Li'l Abner who lived under a black cloud. Second, financial market operators are not brain surgeons. Read Liar's Poker (an engrossing though badly written tale of Salomon Brothers) and you'll gain appreciation for how the luck of the stupid can move markets. Stock and bond traders are in a business that thrives on chaos, and it is in their interest to perpetrate financial uncertainty.

Real estate has also been scarred by the claw of the bear. It seems that a couple of Harvard professors (pay attention to the geography; it speaks volumes) wrote a paper that extends two data series into the future and predicts a continual and universal decline of housing values during the Nineties. This prompted articles in Barrons, a notorious financial tabloid, and the Wall Street Journal (oh, how the mighty have fallen!) proclaiming the death of housing. With these leads, the Eastern media was in full cry. And, of course, since northeastern markets are soft, the whole country must be suffering.

How do we answer these claims? Clearly, direct refutation is useless, since the story appears on page one and the rebuttal among the obituaries. Well, let's look at the reality.

1.Housing markets are local markets. The kinds of value collapse implied by these stories requires a national depression, an event that seems quite remote. Moreover, it implies that all homeowners will default on their mortgages, and live in their cars. Barring these, housing markets will prosper as the local economy prospers, and weaken when the local economy does. The extreme example of this during the Eighties is Houston. It also shows that.....

2.Housing markets swing like pendulums. The psychology of buying and selling real estate is such that housing markets tend to extremes. During the Eighties, New England passed through three distinct phases: a rotten market, followed by an outrageously good market, and then a soft market. Thus it has been, and thus it will be. At any time, a particular market's pendulum can be at any phase, so that.....

3.National housing numbers yield little real information. If one house fewer is sold in San Francisco, but one more is sold in Sacramento, total California sales are unaffected. But the median price will be, since home prices are generally lower in the Central Valley than in the Bay Area. This happens nationally as well: as the (less expensive) Midwest market strengthens and the Northeast flags, national figures show a weaker housing sector. But perhaps the most significant lesson of all is that.....

4.Housing is not a short-term investment. To a great extent, press commentary has focussed on those folks who invested in real estate development hoping to turn a quick profit, and those who realize they missed the peak of their housing market even though their equity has grown significantly over the entire holding period. Housing is a highly leveraged, tax-preferred capital asset that yields shelter services. Over time, the total return on a home will be competitive with the yield on any other use of funds. We estimate that over the course of the Eighties the annual after-tax return to owner-occupied housing was 9.5 percent.

The conclusion here is that the housing sector remains strong. Demand in most parts of the country is strong and most local economies are growing. In some markets, prices will remain flat or slightly down, so that the market can correct itself. But, in the main, 1990 will look very much like 1989 - a generally good year for housing. Our analysis of the longer term suggests that demographic weakness -- the "baby bust" - will not truly affect the housing sector until very late in the decade, and even then, it's unclear as to how this group will behave.

And as far as credit market disorder is concerned: this too shall pass. Interest rates will continue to rise in February and perhaps into March, but eventually market fundamentals will prevail and rates will fall through the second and third quarters of the year. This will stimulate both economic growth and the housing sector. In a sense, it's only natural. Even birds and squirrels know that the cold of winter means that spring is on the way.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The U.S. Department of Commerce estimates that the economy continued to grow in the fourth quarter, but at the very slow inflation-adjusted annual rate of 0.5 percent. This was the lowest estimate of real GNP growth since mid-1986, and it has raised many questions as to whether the economy will tip over into recession during the next few months. Other indicators of the economy's condition continue to give off mixed signals, contributing to the recession/slow growth debate. The GNP report indicated declines in consumption (particularly in autos, food, and clothing), slower investment spending on equipment, and the second consecutive quarterly decline in the trade balance. A hefty run up in non-farm inventories offset these declines, but higher inventory levels cloud the outlook for early 1990, as they could mean slower production in the current quarter. A silver lining in the GNP report was that the slower growth has helped cool the rate of inflation: the implicit price deflator, a broad index of inflation in the economy, rose at only a 3.5 percent annual rate.

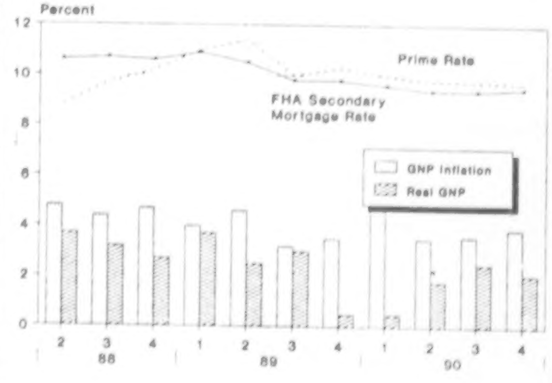
Winter Freeze Sets Fuel Prices Boiling

Shortly after the GNP report was released, another important indicator of the rate of inflation was also released, the producer price index, but it told a different story. According to that measure of inflation, prices at the producer level surged 1.8 percent in January alone, after what had already been a substantial December increase of 0.6 percent. Extended to an annual rate, the January 1.8 percent rise in the index would imply an inflation rate of 23.9 percent! This was the largest monthly gain in fifteen years, and it brought the January 1989 to January 1990 increase in the producer price index up to 5.8 percent. And for the past three months, producer prices have increased at an average annual rate of 10.5 percent. Needless to say, these figures are often the stuff that fuels inflation hysteria. However, these numbers are an aggregation of several sectors, only a few of which are currently hotbeds of inflation. Specifically, energy (up 13.6%) and food (up 2.1%) prices were solely behind the January (and December) surge in prices. In fact, the increase in January producer prices, excluding the energy and food components, was a scant 0.1 percent, or 1.2 percent at an annual rate. Even after adjusting for sweetened auto rebates, which pulled down producer prices, the index advanced at about a 4.0 percent annual rate -- virtually unchanged from a year ago.

Leading Indicators Hold Promise

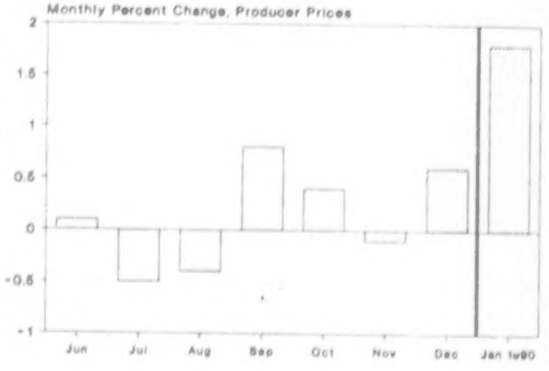
The index of leading indicators rose a strong 0.8% in December, marking its biggest advance since August 1988. The gain brought the index to 0.4% above its year ago level. The index performed very differently during the two halves of 1989. In the first half, the index declined 0.8%, but it more than made up for the loss in the second half, when it rose 1.2%. Generally, the index is used to gauge the health of the economy six to nine months into the future. If so, it means that the current weakness in the economy will not be a prolonged one. This would agree with the current forecast, which projects real GNP growth to reach 1.5 percent in 1990, and 2.3 percent in 1991.

GRAPH 1: THE ECONOMIC OUTLOOK



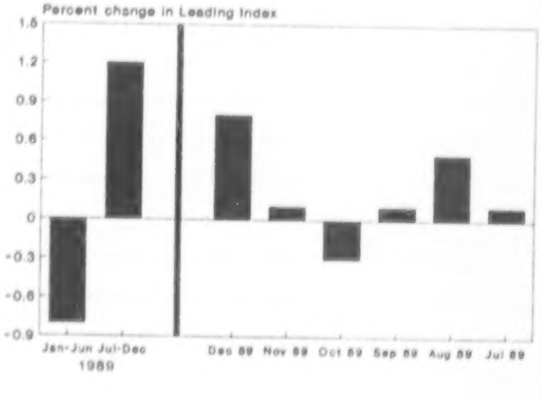
Source: Bureau of Economic Analysis; E NAR estimates

GRAPH 2: PRODUCER PRICES UP SHARPLY



Source: Bureau of Labor Statistics

GRAPH 3: LEADING INDICATORS RISE

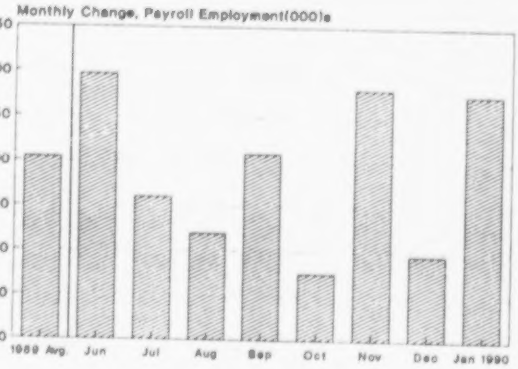


Source: Bureau of Economic Analysis

Unemployment Steady, but Trends Developing

The civilian unemployment rate held steady at 5.3 percent in January for the eighth consecutive month. However, the household survey measures of both the labor force and the unemployed fell. When this contraction is considered along with the news that the number o people working part time for economic reasons and the number on layoff both continued to trend up, has a decidedly negative tone. On the other hand, employment as measured by establishments swelled by a surprising 275,000 -- and this came despite the tenth consecutive drop in manufacturing. Most of the gain in employment came in the construction, retail trade, and services industries. However, the increases in construction and retail trade were distorted by seasonal adjustments and a number of weather-related factors. The decline of 112,000 jobs in manufacturing employment was centered in the transportation equipment sector (which lost 93,000 jobs), as well as in fabricated metals, and rubber and plastics. All of these industries have been affected by the weakness in the auto industry.

GRAPH 4: EMPLOYMENT STILL RISING

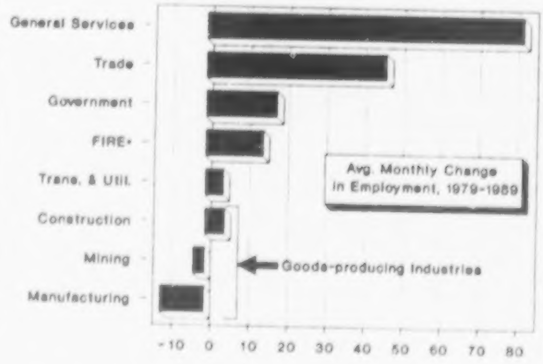


Source: Bureau of Labor Statistics

Employment Growth in the 1980's

While the monthly statistics give the most up to the minute information on the health of the economy, it always helps to put these "trends" in the proper perspective. Employment growth by industry during the 1980's shows that fewer jobs are being created in *goods-producing* industries (like construction, manufacturing and mining), while the *service-producing* industries are today's job generators. Service industries are a diverse bunch, including: general services; retail and wholesale trade; government; finance, insurance, and real estate; and transportation and utilities. Service sector employment as a share of total non-farm employment has been increasing steadily since the late 1950's, and today accounts for more than 3 of every 4 jobs. This shift has been driven by increased demand for services in the production of goods ("general services" include services actually used in the production of goods, like legal, accounting, and advertising services, etc.), rising wealth of the U.S. population, relative price adjustments between goods and services industries, as well as a shift in labor-force demographics. Contrary to what some critics say, service sector job growth is not a sign of economic stagnation, but rather of a wealthy economy able to produce the extra services it demands.

GRAPH 5: EMPLOYMENT GROWTH IN THE 80's

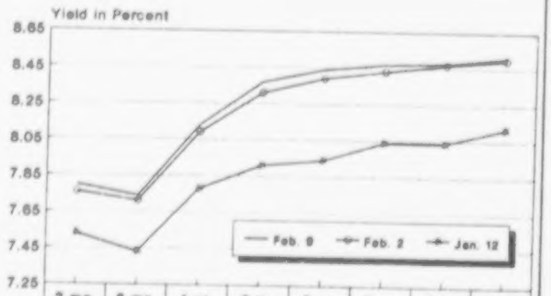


Source: Bureau of Labor Statistics

Interest Rates Go International

For several years now, we have heard of the increasing internationalization of the world's financial markets. The true meaning of this phrase hit home last week when the U.S. Treasury held its quarterly refunding to raise money to pay for the budget deficit. In advance of the auction, bond market players typically try to drive the prices of these securities down (and yields up). This time, there was concern over the slim spread between yields on U.S. and other international instruments. In the end, Japanese investors purchased many of the 3- and 10-year notes, but took less than their usual share of the long-term bond. After the refunding operation, yields softened. But, developments in Eastern Europe and concerns over the U.S. economy suggest continued volatility in rates.

GRAPH 6: QUARTERLY AUCTION RAISES YIELDS



	3 mo.	6 mo.	1 yr.	2 yr.	5 yr.	7 yr.	10 yr.	30 yr.
Feb. 9	7.8	7.74	8.13	8.37	8.44	8.47	8.48	8.51
Feb. 2	7.76	7.71	8.09	8.31	8.39	8.43	8.47	8.5
Jan. 12	7.53	7.43	7.78	7.91	7.94	8.04	8.04	8.12

Source: Federal Reserve

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

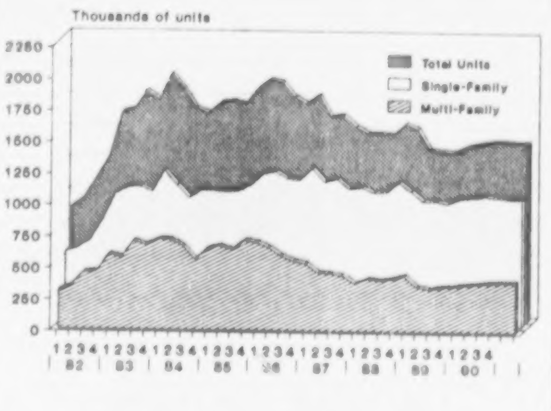
	Total	S-F	2-4	5 and up
Dec 1989	1235	904	53	278
Nov 1989	1342	1003	47	292
Oct 1989	1423	1023	60	340
Sep 1989	1264	971	57	236
Aug 1989	1329	990	56	283
Dec 1988	1577	1141	65	371
Dec 1989 Changes From (%):				
Nov 1989	-8.0	-9.9	12.8	-4.8
Dec 1988	-21.7	-20.8	-18.5	-25.1

REGIONAL DATA

	Northeast	Midwest	South	West
Dec 1989	138	268	439	390
Nov 1989	180	297	488	377
Oct 1989	173	285	567	398
Sep 1989	161	248	486	369
Aug 1989	140	236	563	390
Dec 1988	201	343	609	424
Dec 1989 Changes From (%):				
Nov 1989	-23.3	-9.8	-10.0	3.4
Dec 1988	-31.3	-21.9	-27.9	-8.0

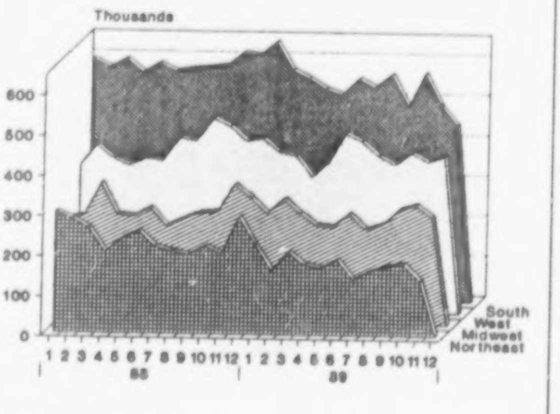
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Starts of privately owned units dropped 8.0% in December to a seasonally adjusted annual rate of 1.235 million units. The December 1989 pace was 21.7% below the December 1988 annual rate of 1.577 million units. Starts of single-family units during December 1989 fell to an annual rate of 904 thousand units, down 9.9% from their November 1989 annual rate of 1.003 million units, and 20.8% below their December 1988 annual rate. Starts of small multi-family structures (those having only 2-4 units) rose to an annual rate of 53 thousand units in December, 12.8% above the November 1989 pace of 47 thousand units, but down 18.5% from the December 1988 annual rate of 65 thousand units. Starts of large multi-family structures (5 or more units) slowed to an annual rate of 278 thousand units, down 4.8% from November 1989, and off 25.1% from December 1988.

Only the West region recorded an increase in total December starts activity, where starts inched up 3.4% to an annual rate of 390 thousand units, but even there, housing starts were 8.0% below their December 1988 pace of 424 thousand units. The Northeast suffered a decline of 23.3% to a December annual rate of 138 thousand, 31.3% below the December 1988 pace. In the South, starts slid 10.0% in December to an annual rate of 439 thousand units, and were 27.9% below their December 1988 pace of 609 thousand units. In the Midwest, starts fell 9.8% in December to 268 thousand units, and were down 21.9% from their December 1988 annual rate.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Dec 1989	629	May 1989	653
Nov 1989	696	Apr 1989	607
Oct 1989	637	Mar 1989	555
Sep 1989	640	Feb 1989	621
Aug 1989	723	Jan 1989	700
Jul 1989	738	Dec 1988	669
Jun 1989	647		

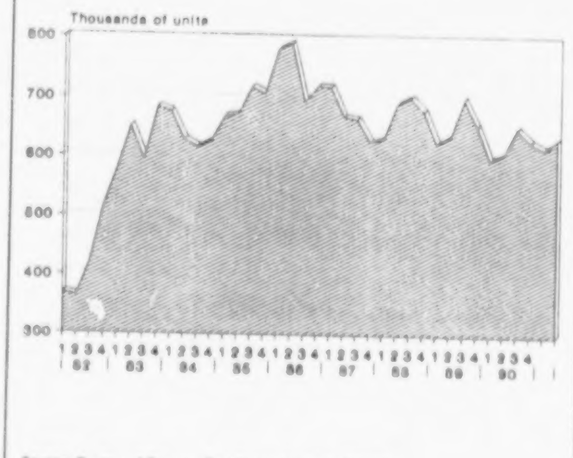
Dec 1989 Changes From:		Annual Totals:	
Nov 1989	-9.6	1989	650
Dec 1988	-6.0	1988	676

REGIONAL DATA

	Northeast	Midwest	South	West
Dec 1989	105	91	243	190
Nov 1989	101	127	259	209
Oct 1989	90	104	273	170
Sep 1989	62	103	261	214
Aug 1989	90	101	294	239
Jul 1989	99	127	282	229
Dec 1988	109	94	263	204
1989	89	103	259	199
1988	101	97	276	202
Dec 1989 Changes From:				
Nov 1989	4.0	-28.3	-6.2	-9.1
Dec 1988	-3.7	-3.2	-7.6	-6.9

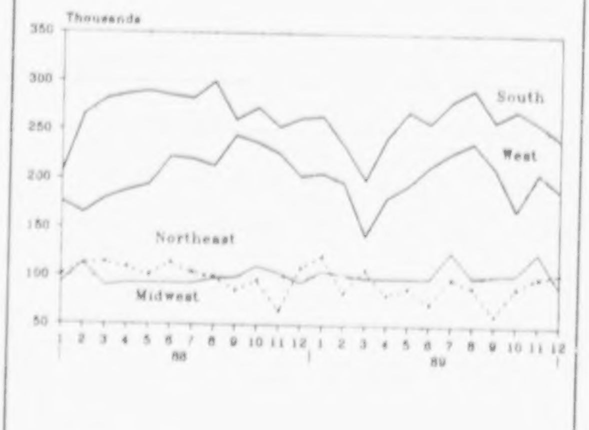
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

After advancing with surprising strength in November, sales of new single-family homes fell back in December to an annual rate of 629 thousand units, 9.6 percent below their November pace of 696 thousand units. New home sales also lagged 6.0 percent behind the December 1988 annual sales rate of 669 thousand units. The weaker December sales figures dropped the 1989 annual total for new single-family home sales to 650 thousand homes, a decline of 3.8 percent from the 1988 annual sales total of 676 thousand homes.

Only the Northeast region recorded an advance in new home sales in December, perhaps related to stronger starts activity in the Northeast during the September through November period. Sales of these new homes rose 4.0 percent during December to an annual rate of 105 thousand units, but remained 3.7 percent below their December 1988 pace of 109 thousand units. In the Midwest, new home sales plummeted 28.3% to an annual rate of 91 thousand units, but were only 3.2 % below their December 1988 sales pace of 94 thousand units. In the South, new home sales fell back modestly to an annual rate of 243 thousand units, 6.2 percent below the November pace of 259 thousand units, and 7.6 percent below the December 1988 pace of 263 thousand units. New home sales in the West region slid to an annual rate of 190 thousand units, down 9.1 percent from the November sales pace of 209 thousand units. Sales in the West were down 6.9 percent from their December 1988 annual rate.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Dec	1989	3550	May	1989	3210
Nov	1989	3590	Apr	1989	3400
Oct	1989	3480	Mar	1989	3400
Sep	1989	3520	Feb	1989	3480
Aug	1989	3480	Jan	1989	3550
Jul	1989	3330	Dec	1988	3920
Jun	1989	3360			

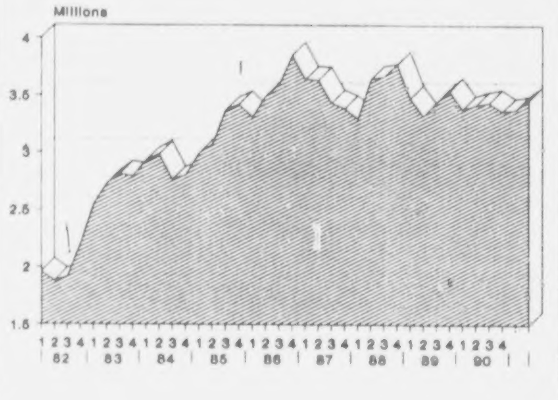
Dec 1989 Changes From (%):			Annual Totals:	
Nov	1989	-1.1	1989	3430
Dec	1988	-9.4	1988	3594

REGIONAL DATA

		Northeast	Midwest	South	West
Dec	1989	570	990	1380	600
Nov	1989	590	960	1430	640
Oct	1989	580	990	1300	620
Sep	1989	590	990	1340	590
Aug	1989	590	980	1350	550
Jul	1989	550	910	1300	570
Dec	1988	700	1010	1500	700
	1989	585	926	1311	605
	1988	673	929	1350	642
Dec 1989 Changes From (%):					
Nov	1989	-3.4	3.1	-3.5	-6.3
Dec	1988	-18.6	-2.0	-8.0	-14.3

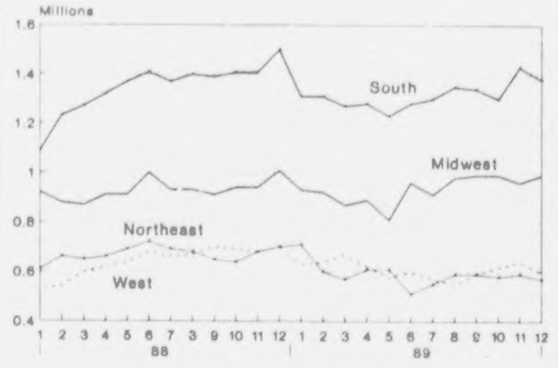
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

While falling slightly in December, sales of existing single-family homes finished 1989 in a strong fashion, recording an average annual rate in the fourth quarter of 3.54 million units. The December pause amounted to a 1.1 percent decline from the November annual rate of 3.59 million units to 3.55 million in December. The December 1989 pace, however, was 9.4 percent slower than the December 1988 annual rate of 3.92 million units. During all of 1989, 3.43 million existing single-family homes were sold. This marked a 4.6 percent decline from the 1988 annual sales total of 3.594 million homes.

Existing home sales rose in the Midwest, but fell in every other region during December. In the Midwest, existing homes were sold at an annual rate of 990 thousand units in December, 3.1 percent faster than the November sales pace of 960 thousand homes. In the Northeast, existing home sales slipped to an annual rate of 570 thousand units in December, 3.4 percent below the November annual rate of 590 thousand units, and 18.6 percent below the December 1988 annual rate of 700 thousand units. In the South, the annual rate of existing home sales dipped 3.5 percent in December to an annual rate of 1.38 million units, and were down 8.0 percent from their December 1988 annual rate of 1.5 million units. In the West, existing home sales fell 6.3 percent in December to an annual rate of 600 thousand units, and were 14.3 percent below the 700 thousand unit sales pace set in December 1988.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

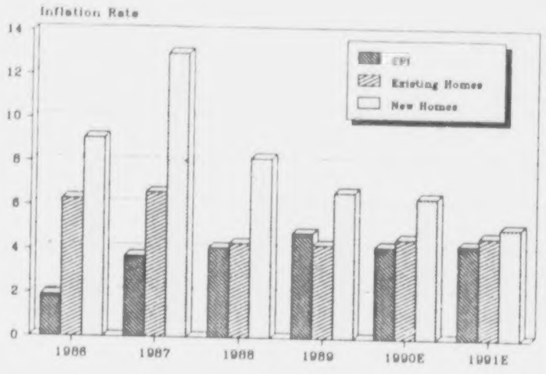
	Median Existing	Median New	Average Existing	Average New
Dec 1989	92,500	130,100	117,000	159,800
Nov 1989	93,200	125,000	118,300	152,100
Oct 1989	92,600	123,000	117,200	147,500
Sep 1989	94,300	120,000	118,400	151,100
Aug 1989	94,800	122,900	120,800	158,600
Dec 1988	88,700	121,000	112,000	147,700
1989	93,100	120,000	118,100	149,300
1988	89,300	112,500	112,800	138,300
Dec 1989 Changes From (%):				
Nov 1989	-0.8	4.1	-1.1	5.1
Dec 1988	4.3	7.5	4.5	8.2

REGIONAL DATA

	Northeast	Midwest	South	West
Dec 1989	143,100	72,100	83,200	135,300
Nov 1989	145,700	71,400	82,400	147,100
Oct 1989	143,200	71,600	83,600	142,300
Sep 1989	145,700	72,200	84,400	147,600
Aug 1989	149,000	71,900	86,100	147,500
Dec 1988	143,000	67,700	78,200	128,700
1989	145,200	71,200	84,500	139,900
1988	143,000	68,400	82,200	124,900
Dec 1989 Changes From (%):				
Nov 1989	-1.8	1.0	1.0	-8.0
Dec 1988	0.1	6.5	6.4	5.1

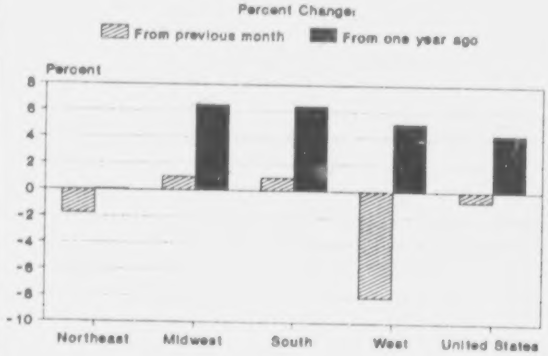
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The median sales price of an existing single-family home sold during December was $92,500, a decline of $700 (or 0.8 percent) from the November median price of $93,200. However, the median price was 4.3 percent above the December 1988 median price. In addition, the median price of an existing home sold during 1989 was $93,100, which means that the median price for an existing home rose 4.3 percent from the 1988 median price of $89,300.

In the Northeast, the median price of an existing single-family home rose 0.1 percent from December 1988 to December 1989. In the Midwest and South, the median price rose 6.5 and 6.4 percent, respectively, during the same period. In the West, the median price of an existing single-family home rose 5.1 percent.

The median price of a new single-family home sold during December was $130,100, an increase of $5,100 (or 4.1 percent) from the November median price of $125,000. The December median price was $9,100 (or 7.5 percent) above the December 1988 median price of $121,000.

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Forecasting & Policy Analysis Division

TAX REFORM AMIDST CHANGING DEMOGRAPHICS:

Prospects For Residential Rental Investment

The effect of tax reform on real estate investment is the subject of continual controversy. Indeed, housing analysts constructed models to gauge the "damage" which would be inflicted even before the Tax Reform Act of 1986 (TRA 1986) actually passed. While opinions differ about the magnitude of the effects of TRA 1986 (and the subsequent modifications in 1987 and 1988), the general consensus of forecasters was that different types of real estate would fare differently and that most of the tax impacts on residential and commercial rental property investment would be "onerous" to individual investors and tax shelter syndicates.

Determining the profitability of rental housing investment by looking through the lens of TRA 1986 gives only a partial picture. The demographic trends driving the demand for rental housing need to be brought into focus, as well. Towards that end, the plan of the discussion is as follows. First, we will review the provisions considered to have the greatest impact on investment in residential rental property. Second, we will look at the "estimated" impacts of TRA 1986 on after-tax equity returns, rents and market values of residential rental property. Third, we will discuss the partial equilibrium (project) models for estimating these impacts. Furthermore, we will examine some demographic and market factors; that is, factors other than tax affecting the feasibility of investment in residential rental property.

The Real Estate Provisions of TRA 1986

TRA 1986 was quite far-reaching in its reform of a great many aspects of economic and business activity. In particular, certain titles and sections overhauled the taxation of investment in residential rental property.

o **Lower Individual Marginal Tax Rates**

TRA 1986 replaces the fourteen bracket tax rate schedule for individuals with four rates: 15, 28, 33, and 28 percent. The 33 percent tax rate is the 28 percent rate with a 5 percent surcharge; the new rates will be adjusted annually for inflation. These tax rate reductions will affect all income, including rents. This will provide incentive to investors in properties which are not experiencing net losses.

o **Elimination of Accelerated Cost Recovery System**

Before the Economic Recovery Tax Act of 1981 (ERTA), there was no established "economic" life of a residential rental property; a "justifiable" life such as 30 to 40 years had to be used for depreciation purposes. The depreciation method was straight-line. Under straight-line, equal depreciation expenses are taken for each year of the property's life.

To offset the prevailing high inflation, ERTA's Accelerated Cost Recovery System (ACRS) sharply shortened tax depreciation lives for residential rental property to 15 years. Under ACRS, the investor was allowed to use the 175% declining balance method for depreciation. Unlike straight-line, the ACRS depreciation expense changes each year and is largest in the earlier years. As inflation subsided, the depreciable life for residential real estate was lengthened to 19 years.

Under TRA 1986, residential rental property is depreciable over 27.5 years. As prior to ERTA, the depreciation method is straight-line. This provides a disincentive to investors because they cannot "recover" the cost of their investment as quickly. Therefore, the present value of the depreciation deduction is reduced.

o **Repeal of Exclusion for Long-term Capital Gains of Individuals and 28-Percent Capital Gains Rate for Taxpayers other than Corporations**

Before TRA 1986, 60 percent of the gain on sale of a capital asset held for more than six months was exempt from taxation; 40 percent of the gain was taxable at the individual's marginal tax rate. After TRA 1986, capital gains on assets not sold before January 1, 1987 are fully taxable at the taxpayer's marginal tax rate.

Additionally, before TRA 1986, the maximum effective tax rate on capital gains was 20 percent (50% maximum marginal tax rate x 40% of gain). After TRA 1986, the maximum effective long-term capital gains rate for taxpayers other than corporations is 28 percent (28% maximum marginal tax rate x 100% of gain). For those very high income taxpayers with income subject to the surcharge, the maximum rate is 33 percent.

o **Passive Activity Losses and Credits Limited**

Prior to TRA 1986, there were no passive activity loss limitations. Under TRA 1986, aggregate losses in a given year from "passive" activities, including residential rental property, are deductible only up to the amount of aggregate income from all passive activities from the same year. Disallowed losses, called suspended losses, may be carried forward indefinitely to offset passive income in future years. Upon sale of a passive activity, all suspended losses may be used immediately to offset passive income, as well as earned and portfolio income.

There is an exception to this for rental real estate activities, all of which are considered passive. That is, $25,000 of losses from rental real estate are deductible against non-passive income, such as wages and salaries, if the investor "actively participated" in the management of the property. This exception is gradually phased out for taxpayers with adjusted gross incomes exceeding $100,000, such that taxpayers with adjusted gross incomes above $150,000 are not eligible for any portion of the $25,000 offset.

o Capitalization and Inclusion in Inventory Costs of Certain Expenses

Prior to TRA 1986, an investor could amortize construction period interest and taxes (CPIT) over 10 years. Under TRA 1986, these costs must be added to the depreciable basis of the residential rental property and depreciated (straight-line) over the 27.5 year life. This means that an investor cannot recover CPIT as rapidly. Expressed differently, the present value of this deduction is reduced, thereby providing a disincentive to invest.

Analyses of Theoretical Market Responses to TRA 1986

Most analysts have agreed that, before the market adjusts, the tax reform provisions would reduce investors' after-tax returns on residential rental property investments. The market has been expected to adjust to the decline in after-tax returns in two ways. In the short run, residential rental property values should decline; in the longer run, rents are expected to increase to compensate equity investors for reductions in tax benefits and restore their pre-TRA 1986 required yield on equity. It should be noted here that if rents adjusted instantaneously, there would be no decline in property value.

Many analysts estimate responses of after-tax yield, market value and rents based on two assumptions about the pre-TRA marginal tax rate of the individual investor -- 45 and 52 percent -- and several holding periods such as 8- and 18-years. Additionally, most have made estimates assuming no decline in interest rates as well as a TRA 1986-induced 100 - 150 basis point decline. The reason for the latter is that by lowering demand for each type of capital asset, TRA 1986 was expected to cause interest rates to decline. Indeed, this has already occurred; however, it is not now statistically possible to determine how much of this decline was due to TRA 1986 or other economic and monetary factors. Finally, by replacing almost-certain tax benefits with less certain rental income, TRA 1986 has increased the "riskiness" of residential rental property investment. Therefore, many analysts have recognized in their modelling that investors will demand higher rates of return than before TRA 1986. Let us take a closer look at the three parameters and TRA 1986's estimated impacts on them.

o After-Tax Yields on Residential Investment Property

Throughout the 1970s, the combined effects of tax shelter, leveraging, low real interest rates and anticipated appreciation produced an excellent after-tax rate of return on equity in residential rental property. This rate of return occurred despite lagging rents. Downs estimates that the real after-tax yield on equity averaged about 7.3 percent a year for 1970 through 1979.[1]

By 1980, dramatic increases in real interest rates and declines in expected appreciation would have substantially lowered the rate of return had not the tax benefits of ERTA more than compensated. Rosen estimated a 10.1 percent after-tax internal rate of return for apartment buildings (assuming a 10-year holding period) before ACRS of ERTA, but a 14.1 percent return under the ACRS.[2]

While there is general consensus that TRA 1986 will reduce after-tax rates of return, estimates of the magnitude of the reduction vary slightly as a result of a wide range of assumptions about holding periods for the investment, investor's marginal tax rate, etc. For example, Rosen estimated that TRA 1986 would reduce the after-tax internal return on apartments by about 700 to 800 basis points from 14.1 percent (under ACRS) to 6.3 percent.[3] Brueggeman and Thibodeau estimated that, with exception of the depreciation of CPIT and the elimination of the investment tax credit which have minimal impact, the cumulative effect of the other provisions would result in a 300 to 500 basis point decline in the after-tax yield on residential rental property from 11.5 percent to about 6.5-8.5 percent, depending on the holding period.[4]

o Market Values

The pricing of residential rental property is similar to the pricing of a bond. "When bonds are earning a below-market coupon rate, they sell at a discount. The more the coupon is below market and the longer the bonds are expected to earn below market coupon, the lower is the market value relative to par."[5] The same applies to the market value (the price an investor is willing to pay) for residential rental property. That is, the value of the property depends on its yield which in turn depends on the rent, among other factors.

Hendershott's estimates of market value responses consider the importance of the "rental adjustment process." This process depends on both the excess supply (vacancies) in an area and the growth rate in the area. That is, in markets in which excess supply was expected to be eliminated rather quickly, e.g., fast growth areas in equilibrium (no excess supply) before TRA 1986, rents should adjust rather quickly. In such areas, market values would be affected minimally. In markets in which excess supply was expected to be eliminated rather slowly, e.g., no growth areas in disequilibrium before TRA 1986, rents should adjust more slowly. In such areas, market values would decline more. Based on his estimated 10 percent rent increase, Hendershott's estimates of TRA-induced declines in market values of residential rental properties ranged from one percent in a fast growth area in equilibrium before TRA 1986 to seven percent for a no-growth area having 10 percent excess capacity before TRA 1986.[6] Brueggeman and Thibodeau estimated expected declines in property values based on 2 holding periods -- 8 and 18 years -- and 2 interest rate assumptions -- no decline and a TRA 1986-induced 150 basis point decline. Their estimates ranged from 16.39 percent (assuming a 18-year holding period and a 150 basis point interest rate decline) to 28.02 percent (for a 8-year holding period and no interest rate decline).[7]

Evidence from a select survey of the nation's largest buyers and sellers of apartment buildings show that apartment building prices did decline (nationally) from the end of 1985 to mid-1986 by about almost seven percent and again from mid- to end of year 1986 by almost three percent. However, more recent data shows a reverse in this trend; i.e., the 2-year (1987-1988) price appreciation rate of apartment buildings was 4.7 percent, higher than the 3.0 percent experienced by all commercial properties combined.[8]

o **Rents**

While market values of residential rental properties were expected to and, in fact, did decline nationally even before TRA 1986 went into effect, rents are theorized to eventually rise to a new equilibrium level. (The equilibrium rent is that at which the demand for and supply of rental housing are equal.) Because rents are determined by supply and demand for rental housing and supply is somewhat inflexible in the short run, rent changes are a longer run adjustment. Also, leases and local laws may constrain the ability of rents to rise immediately. The amount of time necessary for rents to adjust to their new equilibrium level depends on the local rental conditions, e.g., vacancy rate and economic growth of an area. The higher the vacancy rates in rental housing in the area, reflecting excess supply, and the slower the growth in the area, the longer the expected time period before rents adjust. Hendershott suggested that a reasonable guess of the time period before rents rose to their new equilibrium levels would be about three to ten years after TRA 1986 was enacted.[9]

Rent increase estimates ranged from six to 35 percent, depending on assumptions about the investor and the property. Accounting for the probable increase in the rate of return required by investors after TRA 1986, Hendershott, Follain and Ling estimated that for the pre-TRA 45 percent tax rate investor, the required increase is 19 percent; for the 52 percent tax rate investor, the required increase is 33 percent. With a 100 basis point decline in interest rates (and consequently a lower increase in the required after-tax rate of return), they estimated rent increases of 11 and 24 percent for the pre-TRA 45 and 52 percent marginal investor, respectively.[10] Believing (1) the marginal investor before TRA 1986 to have been in the 45 percent tax bracket, (2) that an interest rate decline would result from TRA 1986 and (3) that investors would demand increases in their required returns to offset the increased "riskiness" of residential rental property investment, Hendershott, Follain and Ling estimated a "most likely" rent increase of 10 to 15 percent.[11] Agreeing with (1) through (3), Pellechio estimated a "most likely" rent increase for residential rental property of 7.3 percent.[12]

In a study conducted for the Congressional Research Service, Gravelle estimated the effects of TRA 1986 separately for each type of investor -- corporation, individual, non-tax shelter partnership, tax shelter and "other." Unlike previous analyses in which the individual investor represented the marginal investor, or source of new investment, Gravelle suggests that the corporation is the "theoretically correct" marginal investor.[13] This stems from standard microeconomic theory in which the high cost investor represents the marginal investor. Assuming that the basic technology of operating rental housing is the same for each type of investor, the highest cost investor, and thus the marginal investor, would be the one which bears the heaviest tax -- the corporation. With a 100 basis point interest rate decline, her results for the theoretical corporate investor suggest basically no effect of TRA 1986 on residential rents. Except for those based on tax shelter investors, Gravelle's rent estimates are generally lower than those of other analysts.

While insufficient time has passed to corroborate the estimates of rent changes in most markets, Table 1 shows what has been happening to apartment rents (nationally) since the 1970s. Between 1982 and 1986, rents rose by an average of two percent per year faster than overall inflation; but since then they have remained relatively flat.

TABLE 1

GROWTH IN NOMINAL AND REAL RESIDENTIAL RENTS, 1970-88
(Year-to-Year Percentage Change)

	Nominal Rents*	Real Rents**
1970	4.1%	-1.8%
1971	4.6	0.4
1972	3.5	0.2
1973	4.3	-1.9
1974	5.0	-6.0
1975	5.2%	-3.9%
1976	5.4	-0.3
1977	6.0	-0.5
1978	6.9	-0.8
1979	7.3	-4.0
1980	8.8%	-4.7%
1981	8.7	-1.7
1982	7.6	1.5
1983	5.8	2.5
1984	5.2	1.0
1985	6.1	2.6
1986	5.8%	3.9%
1987	4.1	0.5
1988	3.8	0.3

Source: U.S. Bureau of Labor Statistics.

* This is the percent change over the previous year in the residential rent component of the Consumer Price Index (CPI-U)

** This is the difference between the percent change over the previous year in the residential rent component of the CPI-U and the percent change over the previous year in the CPI-U, all items.

Partial Equilibrium (Project) Models

Market value and rent change estimates discussed in the previous section are based on the results of partial equilibrium (project) models. The terms partial equilibrium indicate that the analysis incorporates only the factors and adjustments affecting the specific investment opportunity. They do not generally reflect overall economic or market adjustments, although certain "general equilibrium" adjustments, such as interest rate declines, can be incorporated into the models.

Partial equilibrium models are essentially spreadsheet models of the discounted cash flows for hypothetical rental projects. Given a host of input assumptions, they calculate the before-tax cash flows and tax liabilities from annual operations, and the after-tax cash proceeds from sale. After calculating these magnitudes, the models then calculate the present value of holding the property and selling it in a given year. As such, the models can be used to determine the effects of complicated tax policy changes on the market value (price that an investor is willing to pay) for a residential rental property. Alternatively, given the market value (price) of the project, the partial equilibrium models can also determine the rent necessary for the investor to achieve his required return on equity.

Limitations of Partial Equilibrium Analyses

The partial equilibrium model provides a useful tool for studying behavioral responses of investors in individual projects to complicated tax policy changes; however, estimates from these models should be interpreted with caution.[14] First, it is apparent from the wide range of value and rent change estimates that the model results are sensitive to assumptions about the investor's tax rate, future interest rates, holding periods for the investment, etc.

Also, the inference of market rent and value responses from partial equilibrium model results is questionable. This is because the necessary assumptions tend to bias rent increase projections, generally in the direction of overstatement.[15] Burman, Neubig and Wilson point out a particularly troubling assumption -- that there exists a marginal investor or a representative investor whose behavior approximates that of the market. Moreover, most analyses assume that the marginal investor before TRA 1986 remains the marginal investor after TRA 1986.[16]

There are several problems with this assumption. First, Burman, Neubig and Wilson point out that the ownership of residential rental property is distributed among significant numbers of individuals in each tax bracket, as well as for corporations and governments; therefore, there is not a representative investor.

The alternative rationale that there is a class of investors which represents the marginal investor is also problematic. While traditional economic theory identifies the highest-cost investor as the marginal investor,[17] many analysts use the individual or tax shelter syndicates, neither of which was the highest-cost investor before TRA 1986 as the marginal investor. Furthermore, tax shelter syndicates account for only a small share of investors in residential rental property.[18]

Burman, Neubig and Wilson also criticize the notion that the marginal investor is the same before and after TRA 1986 on the grounds that tax policy usually involves structural, not simply marginal, change. Therefore, any modelling of tax reform should reflect a change in the marginal investor, if this is the case. For example, while the high tax bracket investor is the low cost investor before TRA 1986, after TRA 1986 this flip flops. By a small margin, the high bracket investor becomes the high cost investor and the low tax bracket investor faces the lowest cost. The result of this "shifting" of the low-cost investor to the investor in a low tax bracket will likely elicit a shift in rental property investment from tax shelter partnerships to tax-exempt and lightly taxed corporations.[19]

To sum up, the partial equilibrium model can be used most effectively to analyze a specific investment opportunity. Even then, the model results are highly sensitive to the input assumptions. For example, if an investor assumed a larger interest rate decline than actually occurred, the model-generated required rent would be lower than what he would actually need to achieve his required rate of return. The inference of market rent and value responses from partial equilibrium models suggests that there exists an investor who truly represents the market. This is suspect since the individual investors in residential rental property are well-distributed in many tax brackets. Corporations and the government invest as well.

More importantly, even if the model were capable of predicting precisely the effects of TRA 1986 on market values and rents, there are other demographic and nontax considerations upon which the feasibility of residential rental investment is also based.

Demographics and Other Nontax Considerations

Unquestionably, investment in housing is dominated in the short-run by vagaries of the economy -- inflation, unemployment, tax reform. As far as tax reform is concerned, it can be argued that housing investment is still playing out the response to the Economic Recovery Tax Act of 1981, 1984 tax legislation and subsequent changes in regulations. So with all of the uncertainty surrounding the "when" and "how long" of tax policy responses, it is prudent to return to the basic economics of housing markets when considering an investment in residential rental property.

Of the three components of investment return on rental housing - tax benefits, before-tax cash flow from operations, and the net proceeds from sale - TRA 1986 has shifted the emphasis of the decision to invest on the latter two. These components of return reflect the economic motivation behind investment and depend to some extent on the changing U.S. demographics. To this end, let us look at some demographic and economic phenomena which affect the rental housing market. While projecting some of these demographic/economic trends may be at least as challenging as anticipating tax law changes, these nontax considerations may, ultimately, prove more important in analyzing the feasibility of investment in residential rental housing investment into the next decade and century.

o **Age Distribution of the Population**

The age distribution of the population has been influenced largely by the post-World War II baby boom, which some have dated from 1946 through 1964. As a consequence of the second wave of the baby boom peaking in 1957 and remaining strong through 1961, the number of people turning 25 - the prime rental group - peaked from 1982 through 1986.[20] Table 2 shows that the population aged 25 to 34 is projected to decline by 13 percent between 1986 and 2000. Table 2 also shows that another key rental group -- people 18 to 24 -- is projected to decline by 14 percent. However, mitigating this to some extent is the 22 percent increase in the population of potential renters age 65 and over.

o **Nontraditional Household Types**

Historically, married couple households, both with and without children, have demonstrated higher propensities to own their homes than other household types. Although their ownership rates have been growing, single-person households -- a fast growing segment of the population -- have exhibited lower propensities to own than married couple households.

Table 3 presents the distribution of households by type. While there are still many more married households, the growths from 1970 to 1980 and 1980 to 1988 for other family, single and other non-family households far surpass the growth in married households. A continued shift from households with high propensities to own to households with lower propensities to own could significantly affect the demand for rental housing.

TABLE 2

U.S. POPULATION BY AGE, 1970-2000
(Population in Thousands)

Population Change

	1970-85		1986P-2000P	
Age	Number	Pct. Chg.	Number	Pct. Chg.
18-24	4,029	16%	-4,138	-14%
25-34	16,984	67	-5,429	-13
35-44	8,609	38	11,678	37
45-64	2,932	7	16,335	36
65+	8,423	42	6,295	22
18 and over	40,977	30	24,741	14

P U.S. Bureau of the Census projection; the Census projections from Report P-25 have been proportionately adjusted to align actual 1985 figures with projections.

Source: U.S. Bureau of the Census, Current Population Reports, Series P-25, Population Estimates and Projections, Number 952 (May 1984) and Number 985 (April 1986).

TABLE 3

HOUSEHOLDS, BY TYPE: 1960-1988
(households in thousands)

	Married Couple	Other Family	Single	Other Non-Family
1960	39,254	5,651	6,906	990
1970	44,728	6,728	10,851	1,094
1975	46,951	8,612	13,939	1,618
1980	49,112	10,438	18,296	2,930
1983	49,908	11,485	19,250	3,275
1984	50,090	11,907	19,954	3,456
1985	50,350	12,356	20,602	3,480
1986	50,933	12,625	21,178	3,722
1987	51,537	12,954	21,128	3,900
1988	51,814	13,295	21,855	4,007
Percent Change 1970-1980	9.8	55.1	68.6	167.8
Percent Change 1980-1988	5.5	27.4	19.5	36.8

Source: U.S. Bureau of the Census, Current Population Reports, Series P-20, No. 4

o **Household Mobility**

Household mobility has been found to be closely correlated with the household's decision to purchase or rent a home. While much remains to be learned about this relationship, intuitively, high transactions costs associated with home ownership, e.g. closing costs, broker's fees etc., justify the decision to purchase a home only for households expecting to be able to spread those costs over a sufficiently long period of time, i.e., for households having low expected mobility.[21] That partially accounts for the difference in the 1985 mobility rates of owners and renters, 8.3 versus 37.7 percent, respectively.

U. S. mobility statistics date from 1948 when 19.9 percent of the population was estimated to have changed residences during the preceding year. Table 4 shows that the national mobility rate remained at about 20 percent until the early 1960s when it seems to have begun a steady, two-decade decline. As indicated in Table 4, the mobility rate seems to have bottomed out in 1982 - 1983 at 16.1 percent.

Since then, mobility seems to be trending upward. Whether this trend will continue is the source of much

TABLE 4

U.S. POPULATION MOBILITY RATES FOR SELECT YEARS, 1948-1987

Year	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]

[illegible]

speculation. But a highly mobile population may augur well for investment in rental housing.

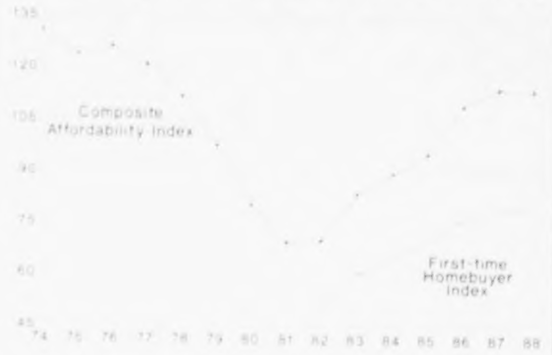
o **Homeownership Affordability**

The affordability of homeownership is determined by many factors including household wealth and income, house prices, monthly housing expenses, mortgage interest rates, instruments and underwriting guidelines. The National Association of Realtors® Composite Affordability Index and First-Time Homebuyers' Affordability Index are two measures which track the relationship between household income and house prices. The first measures the income sufficiency of all prospective homebuyers -- first-time and repeat -- to qualify for a mortgage loan on the median-priced home; the second measures the income sufficiency of prospective first-time homebuyers to qualify for a mortgage loan on the median-priced starter home.

Figure 1 shows that, after declining steadily during the 1970s (when real home prices were escalating faster than real household incomes) and early years of the 1980s, the Affordability Index has risen steadily since 1982. In fact, 1986 was the first year since 1978 that the index was above 100, indicating that the typical family's income was just sufficient to qualify for a mortgage loan on a typical existing home. (It is important to keep in mind that by aggregating over all housing markets, the index masks significant geographic variations in housing affordability.)

Figure 1

Homebuyer Affordability Index, 1974-88



Source: NATIONAL ASSOCIATION OF REALTORS Economics and Research Division

While the Composite Affordability Index has boded well for prospective homebuyers in recent years, the First-Time Homebuyer Affordability Index points out the plight of the typical young household. Although rising since 1982 (the first year of its calculation), the income of the typical first-time homebuyer remained some 22 percent below that needed to qualify for a mortgage loan on a typical starter home in 1988. This inability to meet the ongoing expenses coupled with the difficulty of saving for a downpayment, may make it necessary for some households to postpone homeownership. This postponement would tend to increase the demand for rental housing.

o **Vacancy Rates**

Substantial overbuilding, sparked by the favorable tax provisions of ERTA 1981, is partially responsible for the increasing residential rental vacancy rate between 1982 and 1987. Additionally, the increasingly mobile U.S. population may account for some of the rise in vacancy rates. With a larger proportion of households switching residences at any given time, a larger proportion of vacant units are needed to accommodate these moves.

Vacancy rates differ significantly by metropolitan areas. Even among the four Census regions, there is substantial variation with 1988 vacancy rates ranging from 4.8 percent in the Northeast to 10.2 percent in the South. For the Midwest, the vacancy rate appeared to be levelling off in 1988 at 6.9 percent and in the South, the vacancy rate, though high, actually declined this past year. While vacancy rates are more reflective of shorter term market conditions, they may take on a new significance as a result of the emphasis of TRA

1986 on the economic return rather than tax considerations of investment decisions.

There are other factors that warrant consideration in determining the future returns on investment in rental real estate. For example, do the households of declining size we've witnessed during the 1970s and 1980s have less wealth and income per household? If so, the rental market may be boosted by a large share of smaller households with fewer financial resources per household. Additionally, increased immigration may increase the need for rental housing, especially for states like California, Florida, New York, and Texas. Investors may find that in markets such as these the rents will be sufficient to meet required yields on their equity investments.

Conclusion

While TRA 1986 eliminated many of its tax benefits, rental housing remains a tax-advantaged investment. While the economic life of residential rental property has been lengthened by 8.5 years, it is still much shorter than the 30- to 40- year life before ERTA. Also, depreciation is a non-cash deduction that "active" investors with adjusted gross incomes below $100,000 can use to shelter income from wages, salaries and investments.

Since the provisions of tax reform are less burdensome to some types of investors than to others, there could be a substantial change in the composition of investors in residential rental property. The TRA 1986-induced "shifting" of the low tax bracket investor from the high-cost to low-cost investor could evoke increased interest among tax-exempt and lightly taxed entities. Also, corporations may invest more in residential rental property for several reasons. Passive activity loss limitations do not apply to corporations. Furthermore, before TRA 1986, corporate investment in equipment was favored over structures; this favoritism was eliminated under TRA 1986. Whether corporate investors will invest in similar types of rental properties remains to be seen. A long-run consequence may be a favoring of higher income residential properties and a tilt away from lower income properties.

Of more sustained importance perhaps than changes in the tax code, are the many demographic changes which affect investment in rental housing. While the overall population growth and the age profile of the population are not auspicious, households are now smaller, more mobile and the costs of homeownership are formidable for many of these households. Projections of these demographics may ultimately be more telling than ephemeral tax law changes.

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U.S. ECONOMIC OUTLOOK

FEBRUARY 1990

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL			FORECAST	
	89.3	89.4	90.1	90.2	90.3	90.4	91.1	91.2	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5281	5337	5405	5476	5559	5642	5734	5827	4524	4881	5233	5620	5873
% Change	6.2	4.3	5.2	5.4	6.2	6.1	6.7	6.7	6.9	7.9	7.2	5.5	6.4
% Change (w/out inflation)	3.0	0.5	0.5	1.8	2.5	2.1	2.3	2.6	3.7	4.4	2.9	1.5	2.3
Consumer Price Inflation (CPI)	2.4	4.0	5.7	3.2	3.8	4.4	4.4	4.6	3.7	4.1	4.8	4.2	4.3
GNP Inflation (GNP Deflator)	3.2	3.5	4.8	3.5	3.6	3.9	4.3	4.0	3.1	3.3	4.2	3.9	3.9
Unemployment Rate - Civilian	5.3	5.3	5.5	5.6	5.6	5.7	5.7	5.7	6.2	5.5	5.3	5.6	5.6
Civilian Employment-Household Basis (millions)	117.5	117.8	117.9	118.1	118.4	118.7	119.0	119.3	112.4	115.0	117.3	118.3	119.5
Percent change	0.7	1.0	0.5	0.6	1.0	1.0	1.0	1.3	2.6	2.3	2.0	0.8	1.1
Index of Industrial Production	142.2	142.3	142.5	142.9	143.5	144.3	145.2	146.2	129.8	137.2	141.7	143.3	146.7
Manufacturing Capacity Utilization	84.0	83.1	82.9	82.7	82.8	82.7	82.8	82.9	81.0	83.5	84.0	82.8	82.9
Domestic Auto Sales	7.9	6.2	6.7	6.7	6.7	6.8	6.9	7.0	7.1	7.5	7.1	6.7	7.0
Federal Tax Receipts (NIPA) as % of GNP	19.8	19.8	20.3	20.4	20.4	20.4	20.5	20.4	20.1	19.9	20.0	20.4	20.4
Federal Expenditures (NIPA) as % of GNP	22.5	22.8	22.8	22.7	22.6	22.5	22.6	22.4	23.7	22.9	22.9	22.7	22.4
Deficit(NIPA)	-144	-161	-135	-128	-125	-118	-122	-116	-161	-145	-149	-126	-113
as % of GNP	-2.7	-3.0	-2.5	-2.3	-2.3	-2.1	-2.1	-2.0	-3.6	-3.0	-2.9	-2.3	-1.9
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4408	4487	4369	4409	4444	4359	4364	4448	4647	4649	4408	4395	4397
Percent change -- year ago	-6.0	-7.9	-3.1	2.9	0.8	-2.8	-0.1	0.9	-1.3	0.0	-5.2	-0.3	0.0
Existing Single-family Home Sales (thousands)	3443	3540	3385	3420	3440	3365	3380	3465	3526	3594	3430	3403	3423
Percent change -- year ago	-6.0	-6.1	-2.7	3.0	-0.1	-4.9	-0.1	1.3	-1.1	1.9	-4.6	-0.8	0.6
Housing Starts (thousands)	1337	1333	1377	1396	1417	1418	1409	1411	1633	1494	1385	1402	1401
Percent change -- year ago	-8.8	-14.5	-9.2	3.3	6.0	6.4	2.3	1.1	-9.8	-8.5	-7.3	1.3	-0.1
Single-Family Units	995	976	1014	1020	1035	1025	1014	1013	1156	1088	1008	1023	1004
Percent change -- year ago	-6.1	-14.2	-5.2	2.8	4.0	5.0	0.0	-0.7	-2.2	-5.9	-7.3	1.5	-1.9
Multi-Family Units	342	356	363	375	382	393	395	397	477	406	376	378	396
2-4 Family Units	56	53	54	56	57	58	59	59	65	59	55	56	59
Percent change -- year ago	-0.6	-18.4	-8.4	5.9	0.9	10.3	8.8	5.9	-23.0	-9.5	-5.8	1.9	4.8
5 + Family Units	285	303	308	319	325	334	336	338	412	347	320	322	337
Percent change -- year ago	-18.2	-14.6	-20.4	4.1	14.0	10.3	8.8	5.9	-24.4	-15.6	-7.7	0.3	4.8
New Single-family Home Sales (thousands)	700	654	597	607	651	629	616	633	673	676	650	621	640
HOME PRICES													
Existing Home Prices - Median $(1000)	95.3	92.8	94.1	96.2	99.5	99.6	100.4	102.3	85.6	89.3	93.1	97.4	101.9
Percent change -- year ago	5.7	6.2	5.0	4.5	4.4	7.3	6.7	6.3	5.8	4.3	4.3	4.6	4.7
New Home Prices - Median $(1000)	119.6	126.0	128.7	125.8	128.0	128.4	131.0	130.3	104.5	112.5	120.0	127.7	134.2
Percent change -- year ago	4.1	9.8	9.1	5.7	7.0	1.9	1.8	3.6	13.5	7.7	6.7	6.4	5.1
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year FRM (FHA Secondary)	10.0	9.8	10.0	9.8	9.6	9.6	9.7	9.7	10.2	10.3	10.3	9.8	9.8
1-year ARM (effective rate)	9.3	8.8	8.6	8.5	8.4	8.4	8.5	8.5	8.5	8.5	9.3	8.5	8.6
Corporate AAA Bond Rate	9.0	8.9	9.3	9.0	8.7	8.7	8.8	8.8	9.4	9.7	9.3	8.9	8.8
Government Bond Rate	8.1	7.9	8.3	8.0	7.8	7.8	7.9	7.9	8.6	9.0	8.4	8.0	7.9
Short-Term Interest Rates													
Federal Funds Rate	9.1	8.6	8.1	7.8	7.8	7.9	8.0	8.0	6.7	7.6	9.2	7.9	8.0
3-month T-Bill Rate	7.8	7.7	7.5	7.2	7.2	7.3	7.4	7.4	5.8	6.7	8.1	7.3	7.4
Prime Rate	10.7	10.5	10.0	9.8	9.8	9.8	9.8	9.7	8.2	9.3	10.9	9.8	9.7
Discount Rate	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	5.7	6.2	6.9	7.0	7.0
Value of the U.S. Dollar (Trade-Weighted Avg.)	100.5	97.3	92.7	91.5	91.6	89.8	88.7	87.8	96.9	92.8	98.5	91.4	87.9
Percent change	0.4	-12.2	-17.5	-4.9	0.1	-7.6	-4.9	-3.6	-13.6	-4.3	6.2	-7.2	-3.8

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, Sean Burns and Beth Maerz.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE

Vol. 3, No. 3

March 1990

OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Commerce Department revised its estimate of fourth quarter real GNP growth upwards to 0.9 percent at an annual rate, 0.4 percentage points higher than its preliminary estimate. While the revision was small in size, it was very positive because it implies the economy is a good deal healthier than the original report suggested.
- Nonfarm establishment employment shot up by 372,000 in February, according to the February employment report released by the Bureau of Labor Statistics. In addition, the January employment gain was revised upwards to a gain of 332,000. The strength was centered in both manufacturing and construction.
- Starts of privately owned housing units surged to a seasonally adjusted annual rate of 1.625 million units, nearly 30 percent faster than the December 1989 annual rate of 1.254 million units. January 1990 was the warmest January on record, and it followed the fourth coldest December since December 1985. The January 1990 pace was still 3.2 percent below the January 1989 annual rate of 1.678 million units. Starts of single-family units reached 1.137 million units in January 1990. Starts of housing structures with five or more units shot up almost 51 percent to an annual rate of 434 thousand units, while starts of structures with 2-4 units fell 1.8 percent in January to an annual rate of 54 thousand units
- Sales of existing single-family homes declined to 3.48 million homes in January, 2.2 percent below the December annual rate of 3.56 million units, and 4.9 percent below the January 1989 annual rate of 3.55 million units. The 2.2 percent January decline in existing home sales was likely due to a slight uptick in mortgage interest rates. The NAR housing affordability index fell to 104.2 in January, down from 108.2 in December.

IN THIS ISSUE

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In the Wink of An Eye:
Economic Commentary

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Senior Vice President
Real Estate Finance

A year ago, none of us imagined the degree to which we would be obsessed with the changes occurring in the Soviet Union and Eastern Europe. The fragmentation that threatens to turn the Soviet Union back into the Duchy of Muscovy; the tide of freedom that is transforming the small nations of Central Europe; and the prospect of German reunification, all simultaneously excite and terrify us. Even South Africa appears to be on the brink of major upheaval. Yet, all these changes represent just the boost the world economy needs.

Let's face it; this expansion is tired. Even the Japanese, the marvels of the modern age, are struggling to sustain their high savings, high investment economic machine. The growth of the smaller nations of Asia has helped, but not enough to counter the drag of third world stagnation. Now comes Eastern Europe and the opening up of backward, industrialized markets, ready to soak up the goods of the United States, Western Europe and Japan. Hungary is a good example. The economy, while in disarray, has market structures in place that will serve as conduits for industrial production. Currently for each 1,000 Hungarians there are 155 telephones and 220 private automobiles. The latent demand suggested by these numbers is merely the tip of the iceberg. Many more goods will find willing consumers in Hungary and markets will open up in Poland, Czechoslovakia, East Germany and even in the Soviet Union.

The other side of the equation works as well. Korea, Taiwan, Singapore and Malaysia grew strong on the basis of cheap labor. The Eastern Bloc countries offer the same advantages, combined with lesser language barriers (although Magyar may be as incomprehensible as Chinese). We will see a surge of investment in these nations, and the resulting employment and income will fuel the market for consumer goods. The kind of sluggish demand that appeared to be slowing the world economic expansion will be reversed by the growth of the awakening states of the Communist world.

And there's another aspect to this. These nations are like Rip Van Winkle. When Rip woke up things had changed, and to him trading a president for a king was a big deal. But consider the technological charges of the past two decades and you'll get a feel for what Eastern Europe is awakening to. To return to the Hungarian case, US West is already setting up a cellular phone network as you read this. Going from no phone to car phone is a leap in time that dazzles the mind. It is thus with a whole range of goods from household appliances to production equipment. We live daily within the cutting edge of technological development. To view this process as before and after, as Eastern Europe will, is truly frightening.

The challenge for the U.S. is how can we get into those markets. In the technological area, we appear poised to seize a significant share of the new markets. In heavy production areas -- automobiles, steel manufactured goods -- we are behind Western Europe, but not hopelessly. In financial services, we have no hope; the Japanese, Germans, British and French have closed us out. In a sense, all those scare stories about how our fiscal profligacy will come home to roost have been validated. To the extent we are too weak to invest in new territory, we are closed out of those markets. It is imperative that over the next three to five years, we as a nation need to find ways to participate in this second stage global expansion.

There is a similar challenge affecting real estate. The switch from typewriter to word processor and from MLS book to computer are the beginning. Already, we are seeing reams of statistical and pictorial information being transmitted across electronic MLS wires. In some areas, computerized loan origination systems are placing Realtors directly into the mortgage process. In the future, the real estate office will become an electronic nerve center touching virtually all aspects of the real estate transaction. The challenge to the industry is to manage this change in a positive manner rather than being overwhelmed by it.

It's like an old Star Trek episode, "In the Wink of An Eye." Kirk is absorbed into the world of incredibly fast moving aliens who (invisible because of their speed) are taking over the Enterprise. Eventually, Spock finds a way to join the Captain, and they save the ship. But where Kirk returns, Spock remains in the faster world to make repairs at super speed. The economic development of the Eastern Bloc and the technological change affecting our industry are occurring at a pace reminiscent of that TV show. Then Spock was a Vulcan. Now, is he German, Japanese, or American?

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The U.S. Commerce Department revised its estimate of fourth quarter real GNP growth upwards to 0.9 percent at an annual rate, 0.4 percentage points higher than its preliminary estimate. The force behind the upward revision was stronger than expected net export growth, which led to a steep decline in the December trade deficit. A downward revision in inventory investment partially offset the rise in net exports, but the slower pace of inventory accumulation was greeted as a positive indicator that businesses would not have to cut back on production in the near future. Overall, while the revision was small in size, it was very positive because it implies the economy is a good deal healthier than the original report suggested: a more reasonable balance between demand and production, and a healthier international sector. Indeed, when this report is considered in conjunction with other recent indicators, it suggests the economy has avoided a recession and is poised for slow but steady growth in the year ahead.

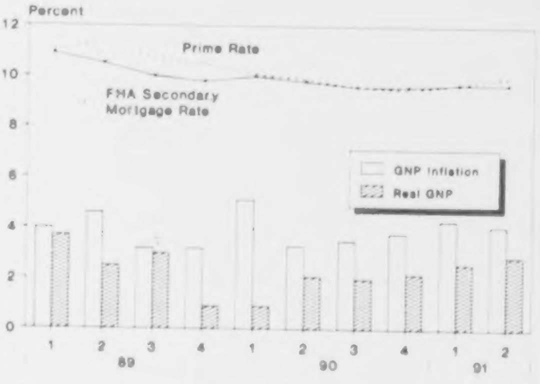
Employment Growth Surpasses Expectations

Chief among these recent indicators is the February employment, which reported that nonfarm establishment employment shot up by 372,000. In addition, the January employment gain was revised upwards to a gain of 332,000. The strength was centered in both manufacturing and construction. Services employment, which had swelled by a massive 351,000 in January, fell back to a gain of 221,000 in February. The gain of 60,000 in construction employment during February was particularly surprising, coming as it did on the heels of a January advance of 104,000. Of course, the mild winter weather is likely the primary reason for this unusual strength, and construction employment gains should drop back somewhat in the March report. The February advance in manufacturing employment broke a string of ten monthly declines. The 90,000 gain was completely due to a rebound in auto industry employment, which surged by 97,000 in February to erase the January drop of the same amount. But therein lies a sobering truth about manufacturing employment: without the rebound in auto jobs, manufacturing employment would have declined for an eleventh straight month.

Manufacturing Sector Is Still Soft

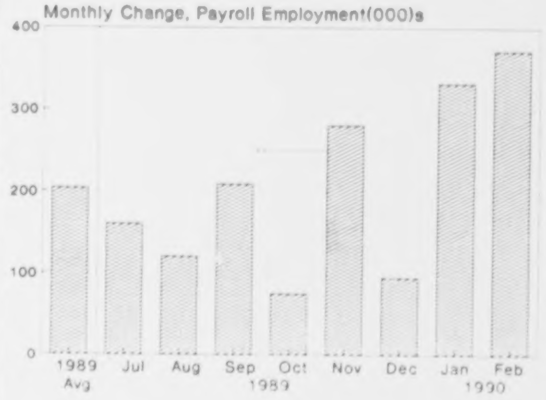
As the employment report suggests, the economy may be in better shape than previously thought, but it is still weak in crucial areas, such as manufacturing. Industrial output, as measured by the index of industrial production, fell 1.1 percent in January after inching up 0.2 percent in December. January's decline was due to a slowdown in auto production, and the warmer weather's dampening effect on utility output, which fell 10.7 percent. Output at the nation's factories, as measured by manufacturing capacity utilization, fell to 81.9 percent, its lowest point since June 1987. Within manufacturing, motor vehicle manufacturers extended their holiday shutdowns to reduce inventories; this lowered their operating rates to near 1982 lows. The operating rate for manufacturing has dropped 3 percentage points during the past year, with most of the decline coming in the last seven months.

GRAPH 1: THE ECONOMIC OUTLOOK



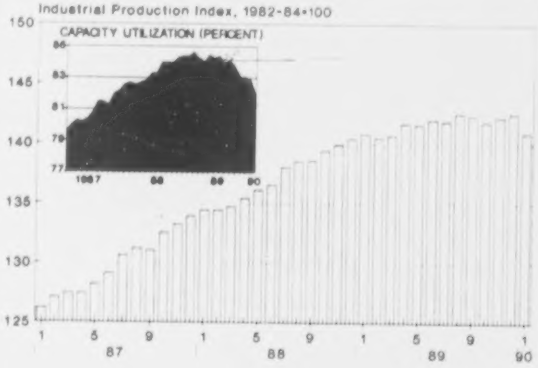
Source: Bureau of Economic Analysis; E NAR estimates

GRAPH 2: PAYROLL EMPLOYMENT SURGES



Source: Bureau of Labor Statistics

GRAPH 3: MANUFACTURING TAKES ITS LUMPS



Source: Bureau of Economic Analysis

Consumer Prices Rise Higher

The consumer price index for all urban consumers surged 1.1 percent in January, powered by increases in food and energy costs, which accounted for over 60 percent of the overall gain. The January increase in the index translates into an annual rate of consumer price inflation of 12.7 percent. The bulk of the food and energy price increases can be attributed to the winter weather: food prices rose in January because of the unusually cold December weather; and prices for fuel oil jumped 26.3 percent, while gasoline prices were up 8.2 percent, after declining in November and December. If the effects of food and energy price changes are netted out, then consumer prices still rose a substantial 0.6 percent. This is the largest monthly gain since January 1984, and amounts to an annual rate of 7.4 percent. On a bit more reassuring note, the 12 month rise in the nonfood, nonenergy component of the consumer price index amounted to only 4.4 percent, slightly below the 4.5 percent average for this statistic during 1989. Perhaps more significant than any of these particular numbers, is an emerging trend of decelerating inflation for goods, and accelerating inflation for services. With the service sector grabbing an ever-increasing share of employment, this will have a much longer lasting effect on the price level than any one winter's surge in food and energy prices.

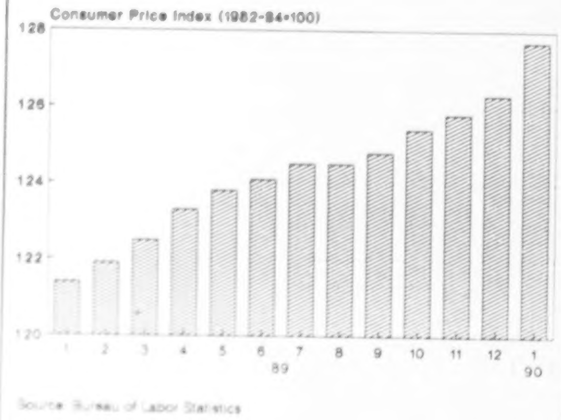
Dollar Strong, Yen Weak

After spending much of the last few years in retreat from its 1985 highs, the dollar has staged a rally in recent months. In fact, it has shown remarkable stubbornness in the face of international central bank intervention efforts aimed at holding down its value in order to restore world trade imbalances. After the employment report was released on Friday, March 9, the dollar hit 151 yen. The strength of the dollar is rather surprising, particularly in light of the small spread between Japanese and U.S. yields (only 150 basis points, down from 400 basis points a year ago). Weakness in the yen is due to the Bank of Japan's refusal to raise interest rates, and the recent turmoil in the Japanese stock market. The dollar is likely to remain firm in the near term, as the positive employment report makes it unlikely that the Federal Reserve will lower interest rates during the next few weeks. Stable U.S. interest rates will maintain foreign interest in the dollar. However, a stronger dollar has the effect of raising the prices of U.S. exports, which makes it difficult for U.S. manufacturers to compete in overseas markets.

Interest Rates Inch Up

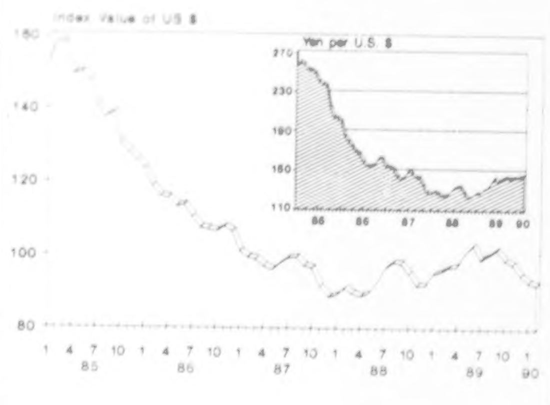
Treasury bill rates and bond yields both crept higher in the week ended March 9. The short-term rates on T-bills moved steadily higher all week. It appears that short-term rates are already reflecting the market's anticipation that the Federal Reserve will continue its tight grip on the money supply. As a sign of the integration of the world's financial markets, U.S. bond yields slipped on Thursday following a small decline in foreign bond yields, but Friday's employment report pumped bond yields back up. The Federal Reserve's task of administering monetary policy in an age of linked financial markets, in the words of Chairman Greenspan is, "more difficult."

GRAPH 4: CONSUMER PRICES RISE



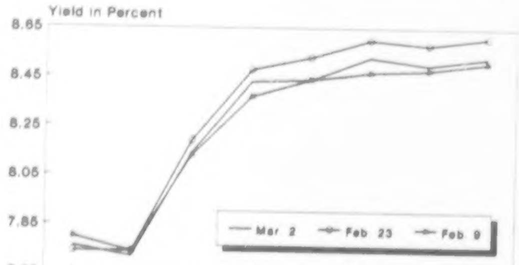
Source: Bureau of Labor Statistics

GRAPH 5: AN END TO A FALLING DOLLAR?



Source: Bureau of Labor Statistics

GRAPH 6: THE YIELD CURVE



	3 mo.	6 mo.	1 yr.	2 yr.	5 yr.	7 yr.	10 yr.	30 yr.
Mar. 2	7.76	7.72	8.14	8.43	8.44	8.53	8.5	8.53
Feb. 23	7.74	7.74	8.19	8.48	8.53	8.6	8.58	8.61
Feb. 9	7.8	7.74	8.13	8.37	8.44	8.47	8.48	8.51

Source: Federal Reserve

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

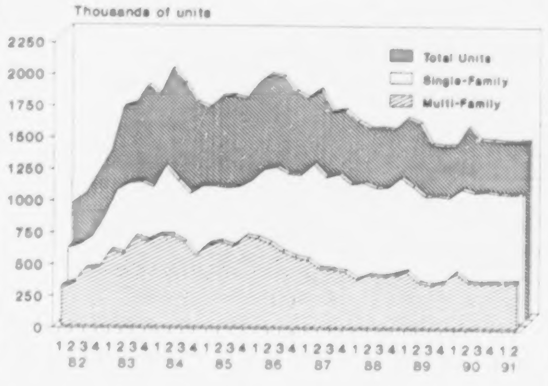
	Total	S-F	2-4	5 and up
Jan 1990	1625	1137	54	434
Dec 1989	1254	911	55	288
Nov 1989	1347	1010	47	290
Oct 1989	1423	1023	60	340
Sep 1989	1264	971	57	236
Jan 1989	1678	1199	66	413
Jan 1990 Changes From (%):				
Dec 1989	29.6	24.8	-1.8	50.7
Jan 1989	-3.2	-5.2	-18.2	5.1

REGIONAL DATA

	Northeast	Midwest	South	West
Jan 1990	194	388	532	511
Dec 1989	140	272	427	415
Nov 1989	179	296	498	374
Oct 1989	173	285	567	398
Sep 1989	161	248	486	369
Jan 1989	293	313	642	430
Jan 1990 Changes From (%):				
Dec 1989	38.6	42.6	24.6	23.1
Jan 1989	-33.8	24.0	-17.1	18.8

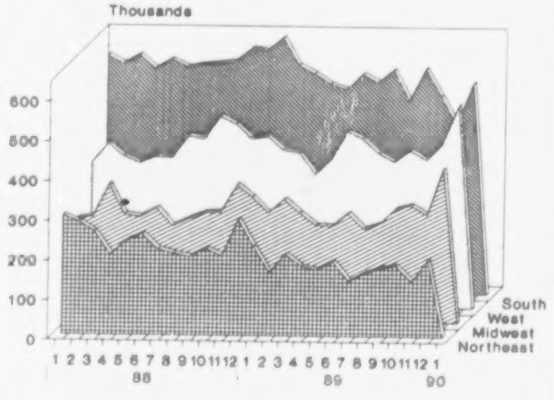
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Starts of privately owned housing units surged to a seasonally adjusted annual rate of 1.625 million units, nearly 30 percent faster than the December 1989 annual rate of 1.254 million units. January 1990 was the warmest January on record, and it followed the fourth coldest December since December 1985. The January 1990 pace was still 3.2 percent below the January 1989 annual rate of 1.678 million units. Starts of single-family units reached 1.137 million units in January 1990, 24.8 percent faster than the December 1989 annual rate of 911 thousand units, but 5.2 percent slower than the January 1989 annual rate of 1.199 million units. Starts of housing structures with five or more units shot up almost 51 percent to an annual rate of 434 thousand units, and were up 5.1 percent from the January 1989 pace of 413 thousand units. Starts of structures with 2-4 units fell 1.8 percent in January to an annual rate of 54 thousand units, and were down 18.2 percent from their January 1989 annual rate of 66 thousand units.

The gain in total housing starts activity was enjoyed by all major regions. In the Northeast, the rate of January starts increased 38.6 percent above December 1989, but were still 33.8 percent below their January 1989 pace. In the Midwest, starts rose 42.6 percent in January, and were 24 percent above their year ago pace. In the South, starts jumped 24.6 percent in January, but remained 17.1 percent below the January 1989 pace. In the West, starts were up 23.1 percent, and were 18.8 percent above last January.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Jan	1990	589	Jun	1989	647
Dec	1989	634	May	1989	653
Nov	1989	692	Apr	1989	607
Oct	1989	636	Mar	1989	555
Sep	1989	640	Feb	1989	621
Aug	1989	723	Jan	1989	700
Jul	1989	738			

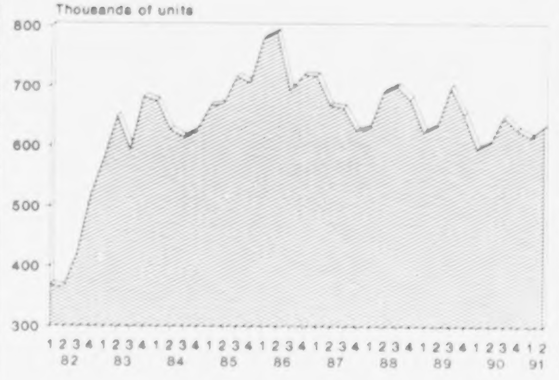
Jan 1990 Changes From:		Annual Totals:	
Dec 1989	-7.1	1988	676
Jan 1989	-16.3	1989	650

REGIONAL DATA

	Northeast	Midwest	South	West
Jan 1990	109	88	202	190
Dec 1989	96	87	249	202
Nov 1989	97	120	264	211
Oct 1989	88	101	271	176
Sep 1989	62	103	261	214
Aug 1989	90	101	294	239
Jan 1989	115	106	274	209
1989	87	102	260	201
1988	101	97	276	202
Jan 1990 Changes From:				
Dec 1989	13.5	1.1	-18.9	-5.9
Jan 1989	-5.2	-17.0	-26.3	-9.1

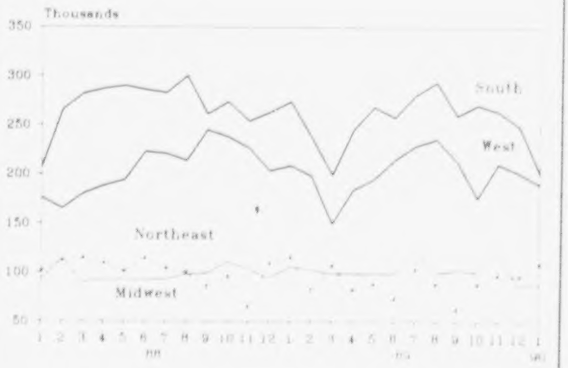
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census, Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

Sales of new single-family homes slowed to an annual rate of 589 thousand units, a 7.1 percent decline from the December 1989 pace of 634 thousand units, and 16.3 percent below the January 1989 annual rate of 700 thousand units. The unusually warm January weather which contributed to a surge in starts activity will affect new home sales in a similar fashion, but after about a two month lag. However, the new home sales data series is notorious for its wide monthly fluctuations, so it may be hard to precisely identify when the surge in starts actually works its way into the new home sales numbers.

During all of 1989, 650 thousand new single-family homes were sold, a decline of 3.8 percent from the 1988 annual total of 676 thousand units.

By region, the Northeast and Midwest showed some gains from December levels, but all regions were below their year ago levels. In the Northeast, new home sales rose strongly to 109 thousand units, 13.5% above the December pace of 96 thousand units, but 5.2% below the January 1989 pace of 115 thousand units. In the Midwest, new home sales inched up 1.1% to 88 thousand units, but were down 17% from their January 1989 pace of 106 thousand units. In the South, new home sales fell 18.9% to 202 thousand units, and were down 26.3% from their January 1989 pace of 274 thousand units. In the West, sale slipped 5.9 percent to an annual rate of 190 thousand units in January, and were down 9.1 percent from a year ago.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Jan	1990	3480	Jun	1989	3360
Dec	1989	3560	May	1989	3210
Nov	1989	3590	Apr	1989	3400
Oct	1989	3480	Mar	1989	3400
Sep	1989	3520	Feb	1989	3480
Aug	1989	3480	Jan	1989	3550
Jul	1989	3330			

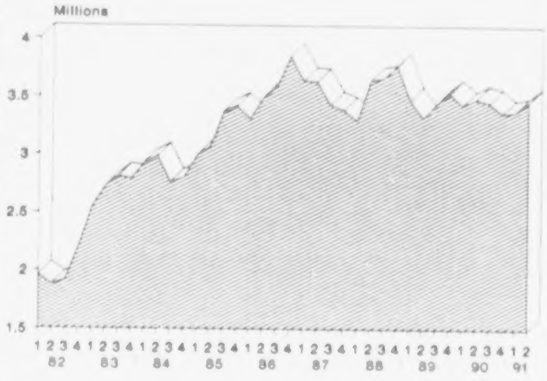
Jan 1990 Changes From (%):		Annual Totals:	
Dec 1989	-2.2	1989	3440
Jan 1989	-4.9	1988	3594

REGIONAL DATA

	Northeast	Midwest	South	West
Jan 1990	560	960	1400	540
Dec 1989	580	980	1390	610
Nov 1989	590	960	1430	640
Oct 1989	580	990	1300	620
Sep 1989	590	990	1340	590
Aug 1989	590	980	1350	550
Jan 1989	680	950	1360	660
1989	589	919	1307	610
1988	673	929	1350	642
Jan 1990 Changes From (%):				
Dec 1989	-3.4	-2.0	0.7	-11.5
Jan 1989	-17.6	1.1	2.9	-18.2

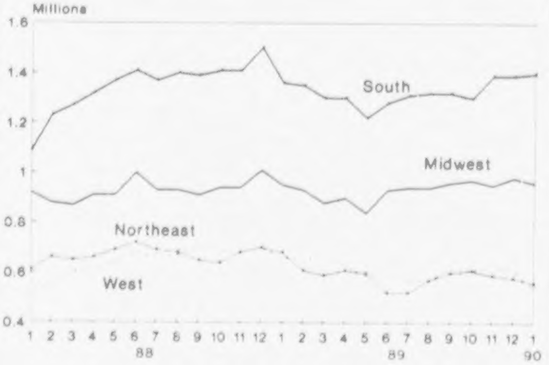
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

Sales of existing single-family homes declined to 3.48 million homes in January, 2.2 percent below the December annual rate of 3.56 million units, and 4.9 percent below the January 1989 annual rate of 3.55 million units. In 1989, a total of 3.44 million existing single-family homes were sold, 4.3 percent below the 1988 annual total of 3.594 million homes. The 2.2 percent January decline in existing home sales was likely due to a slight uptick in mortgage interest rates during that typically slow month. The mortgage rate rise combined with a higher January median home price to cause a slight decline in housing affordability. The NAR housing affordability index fell to 104.2 in January, down from 108.2 in December. However, when the index is above 100, it means that a family earning the national median income has 100 percent of the income needed to qualify for conventional financing covering 80 percent of a home priced at the national median price.

By region, the pace of existing home sales fell in the Northeast, West and Midwest. In the South, the annual rate of existing home sales increased 0.7 percent in January, and was 2.9 percent higher than a year ago. In the Northeast, existing home sales slipped 3.4 percent from December and fell 17.6 percent below January 1989. In the Midwest, resales fell 2.0 percent in January, but were 1.1 percent above the January 1989 annual rate. In the West, resales were 11.5 percent below their December annual rate, and 18.2 percent below a year ago.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

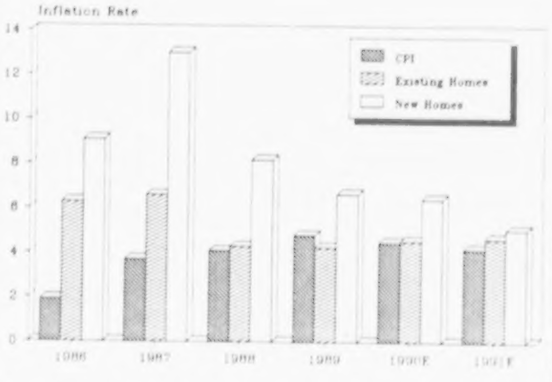
	Median Existing	Median New	Average Existing	Average New
Jan 1990	96,200	127,000	120,100	152,600
Dec 1989	92,500	125,200	118,100	157,200
Nov 1989	93,200	125,000	118,300	151,800
Oct 1989	92,600	123,000	117,200	147,800
Sep 1989	94,300	120,000	118,400	151,100
Jan 1989	89,800	113,000	113,600	138,600
1989	93,100	120,000	118,100	148,800
1988	89,300	112,500	112,800	138,300
Jan 1990 Changes From (%):				
Dec 1989	4.0	1.4	1.7	-2.9
Jan 1989	7.1	12.4	5.7	10.1

REGIONAL DATA

	Northeast	Midwest	South	West
Jan 1990	147,000	74,600	86,300	144,000
Dec 1989	143,400	72,500	82,700	135,200
Nov 1989	145,700	71,400	82,400	147,100
Oct 1989	143,200	71,600	83,600	142,300
Sep 1989	145,700	72,200	84,400	147,600
Jan 1989	143,800	68,000	82,000	134,600
1989	145,200	71,300	84,500	139,900
1988	143,000	68,400	82,200	124,900
Jan 1990 Changes From (%):				
Dec 1989	2.5	2.9	4.4	6.5
Jan 1989	2.2	9.7	5.2	7.0

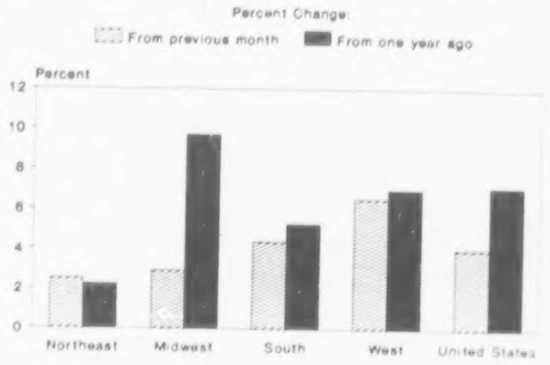
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The national median price of an existing single-family home was $96,200, an increase of 4.0 percent from the December median price of $92,500. The unusual mid-winter surge in existing home prices brought the January 1990 median price to a full 7.1 percent above the January 1989 median price of $89,800.

By region, the median price rose 2.5 percent in the Northeast to $147,000, and was 2.2 percent above the year ago median price of $143,800. In the Midwest, the median price increased 2.9 percent in January to $74,600, and was 9.7 percent above the year ago median price of $68,000. In the South, the median price rose 4.4 percent in January to $86,300, and was 5.2 percent above the year ago median price of $82,000. In the West, the median price rose 6.5 percent to $144,000, and was 7.0 percent above the year ago median price of $134,500.

The median price of a new single-family home increased a modest 1.4 percent in January to $127,000. However, the January 1990 median price was 12.4 percent above the January 1989 median new home price of $113,000. The average new single-family home price fell 2.9 percent to $152,600, but remained 10.1 percent above the January 1989 average price of $138,600.

Sean A. Burns
Director of Forecasting
Forecasting & Policy Analysis Division

U.S. ECONOMIC OUTLOOK

MARCH 1990

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL			FORECAST	
	89.3	89.4	90.1	90.2	90.3	90.4	91.1	91.2	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5281	5338	5416	5488	5564	5647	5743	5842	4524	4881	5233	5529	5887
% Change	6.2	4.4	6.0	5.4	5.6	6.1	7.0	7.0	6.9	7.9	7.2	5.6	6.5
% Change (w/out inflation)	3.0	0.9	0.9	2.1	2.0	2.2	2.6	2.9	3.7	4.4	3.0	1.7	2.4
Consumer Price Inflation (CPI)	2.8	4.0	6.8	3.0	3.7	4.3	4.3	4.5	3.7	4.1	4.8	4.5	4.2
GNP Inflation (GNP Deflator)	3.2	3.2	5.1	3.3	3.5	3.8	4.3	4.1	3.1	3.3	4.2	3.9	3.9
Unemployment Rate - Civilian	5.3	5.3	5.3	5.4	5.5	5.5	5.6	5.5	6.2	5.5	5.3	5.4	5.5
Civilian Employment-Household Basis (millions)	117.5	117.8	118.2	118.4	118.7	119.0	119.3	119.7	112.4	115.0	117.3	118.6	119.9
Percent change	0.7	1.0	1.5	0.7	1.0	0.9	1.1	1.4	2.6	2.3	2.0	1.1	1.1
Index of Industrial Production	142.2	142.2	141.9	142.7	143.2	144.0	144.9	146.0	129.8	137.2	141.7	142.9	146.3
Manufacturing Capacity Utilization	84.0	83.0	82.2	82.2	82.3	82.6	82.9	83.4	81.0	83.5	83.9	82.3	83.4
Domestic Auto Sales	7.9	6.2	6.8	6.7	6.7	6.8	6.9	7.0	7.1	7.5	7.1	6.8	7.0
Federal Tax Receipts (NIPA) as % of GNP	19.8	19.8	20.2	20.3	20.4	20.4	20.5	20.5	20.1	19.9	20.0	20.3	20.4
Federal Expenditures (NIPA) as % of GNP	22.5	22.7	22.7	22.6	22.4	22.3	22.4	22.3	23.7	22.9	22.8	22.5	22.2
Deficit(NIPA)	-144.0	-153.0	-138.0	-122.0	-110.0	-105.0	-110.0	-104.0	-161.0	-145.0	-147.0	-118.0	-103.0
as % of GNP	-2.7	-2.9	-2.5	-2.2	-2.0	-1.9	-1.9	-1.8	-3.6	-3.0	-2.8	-2.2	-1.8
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4408	4489	4454	4476	4452	4348	4361	4449	4645	4646	4418	4432	4455
Percent change -- year ago	-6.0	-7.9	-1.2	4.5	1.0	-3.1	-2.1	-0.6	-1.3	0.0	-4.9	0.3	0.5
Existing Single-family Home Sales (thousands)	3443	3537	3435	3485	3455	3365	3380	3465	3526	3594	3440	3435	3484
Percent change -- year ago	-6.0	-6.2	-3.2	4.3	0.3	-4.9	-1.6	-0.6	-1.1	1.9	-4.3	-0.1	1.4
Housing Starts (thousands)	1337	1341	1492	1388	1384	1373	1373	1381	1630	1491	1384	1409	1367
Percent change -- year ago	-9.1	-13.1	-0.9	2.5	3.5	2.4	-8.0	-0.5	-10.0	-8.6	-7.1	1.8	-3.0
Single-Family Units	995	981	1051	1022	1028	1013	1011	1014	1154	1085	1008	1028	1001
Percent change -- year ago	-6.4	-13.0	-1.2	3.1	3.4	3.3	-3.8	-0.8	-2.4	-5.9	-7.2	2.1	-2.6
Multi-Family Units	342	360	441	365	355	360	362	367	476	405	376	380	365
2-4 Family Units	56	54	66	54	53	54	54	55	65	58	55	57	54
Percent change -- year ago	-4.0	-14.3	12.3	2.8	-4.7	0.1	-18.0	0.6	-22.9	-10.0	-5.4	2.8	-4.0
5 + Family Units	286	306	375	310	302	306	307	312	411	346	321	323	310
Percent change -- year ago	-18.2	-13.2	-1.9	0.5	5.7	0.1	-18.0	0.6	-24.5	-15.7	-7.4	0.8	-4.0
New Single-family Home Sales (thousands)	699	654	597	607	651	629	616	633	673	676	650	621	640
Percent change -- year ago	-0.5	-4.1	-12.7	-4.6	-6.9	-3.8	3.2	4.3	-9.6	0.4	-3.8	-4.5	3.1
HOME PRICES													
Existing Home Prices - Median $(1000)	94.9	92.7	94.8	96.9	99.1	99.6	100.8	102.3	85.6	89.3	93.1	97.6	102.1
Percent change -- year ago	5.2	6.1	3.9	4.2	4.4	7.4	6.3	5.6	6.6	4.3	4.3	4.8	4.6
New Home Prices - Median $(1000)	119.6	124.4	128.9	125.7	128.0	128.4	131.0	130.3	104.5	112.5	120.0	127.8	134.2
Percent change -- year ago	4.1	9.8	9.1	5.7	7.0	3.2	1.6	3.7	13.6	7.7	6.7	6.5	5.0
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year Fixed Rate Mortgage (FHA Secondary)	10.0	9.8	10.0	9.8	9.6	9.6	9.7	9.7	10.2	10.3	10.3	9.8	9.8
1-year ARM (effective rate)	9.3	8.8	8.6	8.5	8.4	8.4	8.5	8.5	8.5	8.5	9.3	8.5	8.6
Corporate AAA Bond Rate	9.0	8.9	9.1	8.9	8.7	8.7	8.8	8.8	9.4	9.7	9.3	8.9	8.8
Government Bond Rate	8.1	7.9	8.3	8.1	7.8	7.9	8.1	8.3	8.6	9.0	8.4	8.0	8.3
Short-Term Interest Rates													
Federal Funds Rate	9.1	8.6	8.2	8.0	7.8	7.9	8.0	8.1	6.7	7.6	9.2	8.0	8.1
3-month T-Bill Rate	7.8	7.7	7.5	7.4	7.2	7.3	7.4	7.5	5.8	6.7	8.1	7.4	7.5
Prime Rate	10.7	10.5	10.1	9.9	9.6	9.5	9.7	10.0	8.2	9.3	10.9	9.8	10.0
Discount Rate	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	5.7	6.2	6.9	7.0	7.0
Value of the U.S. Dollar (Trade-Weighted Avg.)	100.5	97.3	92.3	91.4	90.8	89.7	89.3	88.5	96.9	92.8	98.5	91.0	88.8
Percent change	0.4	-12.2	-18.8	-4.1	-2.4	-4.7	-1.6	-3.7	-13.6	-4.3	6.2	-7.6	-2.4

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE

Vol. 3, No. 4

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OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce released its final revision to real GNP growth for the fourth quarter, marking the overall growth estimate at 1.1 percent. This latest estimate was another 0.2 percentage points higher than the last estimate, and more than double the preliminary estimate of 0.5 percent released in January. This latest revision was made on the basis of several small upward adjustments to personal consumption expenditures, business fixed investment, net exports, and government purchases.
- The Bureau of Labor Statistics reported that the civilian worker unemployment rate was 5.2 percent, down slightly from 5.3 percent, a rate that had held constant for nine months. Payroll employment growth, after surging ahead in both January and February, slowed to an advance of only 26,000 jobs during March. Construction employment fell by 65,000, following large gains in January and February.
- After surging in January, starts of privately owned housing units fell back in February to an annual rate of 1.477 million units, 7.0 percent below the January rate of 1.588 million units, but 0.8 percent above the February 1989 annual rate of 1.465 million units. A substantial decline in multi-family starts activity was to blame. Starts of single-family units rose in February to an annual pace of 1.166 million units, up 5.1 percent from 1.109 million units in January, and up 13.3 percent from their year ago rate.
- Sales of existing single-family homes eased slightly in February as slightly higher interest rates and a sluggish economy combined to soften housing demand in that month. Existing home sales slipped to an annual rate of 3.440 million units in February, a decrease of 2.3 percent from the January 1990 annual sales rate of 3.52 million units. The February 1990 sales rate was 3.1 percent below the 3.48 million annual rate of existing homes sales during February 1989.

IN THIS ISSUE

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STOP,LOOK AND LISTEN

Economic Commentary

by
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Chief Economist
and Senior Vice President
Real Estate Finance

The coming of April brings with it a note of sadness, and I don't mean income taxes. Rather, the greatest athletic spectacle this country has to offer--the NCAA basketball tournament--is over. The triumph of the scholar-athletes from Las Vegas may not be victory for righteousness, but it certainly recognizes sports achievement. We close out a month of last minute basket, shocking upsets and the bittersweet run of Loyola Marymount. We'll miss all these (at least until next year), but one thing even the most rabid fan will not miss is the non-stop ravings of Dick Vitale, perhaps the most annoying sportscaster this side of Howard Cosell. Vitale's average utterance exceeds fifty words; he has been known to pile together hundreds of meaningless phrases into one great burst of audible garbage; he is a shameless self-promoter and defender of the indefensible (c.f. Jim Valvano); and unfortunately he may be the perfect symbol of our time.

We have developed a national habit of rushing events and judgements. Alvin Toffler called it "future shock", but even he must be amazed at the speed with which we tend to move from event to exploitation. What is at first a human tragedy becomes the source of popular amusement. Thus, Charles Stuart, who may or may not have killed his wife in Boston, commits suicide and 48 hours later the script for a made-for-TV movie is drafted. The long slow process of consideration and digestion of actions, developments and their meanings are swallowed up in the drive to hype, sensationalize and trivialize.

The economy is no more immune from this than any other facet of our society. When a figure--any figure--is announced, it is subjected to intense scrutiny to determine whether or if it signals impending recession or the resumption of a vigorous expansion. Reflection suggests that in an economy as detailed and complex as ours, no one number "signals" anything. After all, in October 1987, we got what we thought was the biggest number of all, but found that it signified very little.

Part of the reason for this intense focus on pork belly future prices or the output index of Japanese farms of less than 50 acres is a carryover from the pace of society. We have an obsessive "need to know" about everything. But part of it is based on two significant changes in the economy. In an age where information moves instantaneously, financial fortunes are made or lost on the slimmest of margins, and finding the obscure statistic that points to the future can, in fact, be the equivalent of discovering gold.

In addition, the economy itself has changed. The demise of the savings and loan industry is the symptom of a financial system in rapid evolution. The responses that Federal Reserve policy, for example, evokes in money markets can no longer be calibrated by the same measuring tools and the physics of finance has lost its Newton without yet discovering its Einstein.

Thus, the old truths fail us: falling profits no longer presage a recession in a world where increased leverage ratios have depressed the reported profits of firms that are doing quite well. When you read in the Wall Street Journal that business cycle scholars differ or have continually predicted the invisible recession, it's not necessarily that they're just being economists. Rather, models developed on old truth are often inadequate when there's a change in the way the world works.

Real estate is much the same. We seize upon the fact that the Northeast markets has flattened to predict a massive housing bust. Well, there was a time when real estate markets moved together, but that no longer happens. It is simply impossible to generalize from the course of sales prices in a single part of the country to the country as a whole. The correct analysis is to look at regional economies, changes in financial markets, shifts in the structure of the real estate business and then *reason* to the likely course of the real estate sector over the longer run.

This is not easy, and doing it may make you lose the quick profit opportunity. But ultimately, survivors will go through this kind of thought process and will prosper over the long haul. Short term wisdom and long term wisdom don't always coincide, and when given the choice, go with the latter.

If you go out and price radio equipment you will find that receivers cost twice as much as transmitters. They are far more complex to construct and usually of higher technical quality. Human beings are not much different. In a world where the din of instant analysis can often be deafening, the power to discern can be a costly acquisition, but one that ultimately pays much more than it costs. The good Lord gave us two ears and one mouth. Maybe that's a hint about the ratio in which we should use them.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The U.S. Department of Commerce released its final revision to real GNP growth for the fourth quarter, marking the overall growth estimate at 1.1 percent. This latest estimate was another 0.2 percentage points higher than the last estimate, and more than double the preliminary estimate of 0.5 percent released in January. This latest revision was made on the basis of several small upward adjustments to personal consumption expenditures, business fixed investment, net exports, and government purchases. None of these in itself fundamentally alters the slow growth tone of the quarter, or the state of the economy's health heading into 1990. More significantly, inventory investment was revised downward by a hefty $4 billion. While this drag on growth was offset by the numerous small increases mentioned above, it brings welcome news that inventory levels are not as high as originally thought. This means that there is less need to restrain production due to high inventories, and the $5.7 billion upward revision in the final sales component of real GNP suggests a stronger level of demand.

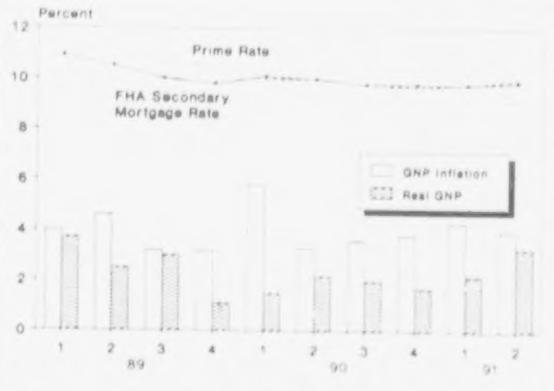
Unemployment Down, but Job Growth Slows

The Bureau of Labor Statistics reported that the civilian worker unemployment rate was 5.2 percent, down slightly from 5.3 percent, a rate that had held constant for nine months. Payroll employment growth, after surging ahead in both January and February, slowed to an advance of only 26,000 jobs during March. In the goods-producing sector, construction employment fell by 65,000, following large gains in January and February. Manufacturing employment growth continued to disappoint, as factory employment slid by another 30,000 jobs in March. Employment losses in manufacturing were widespread, although auto industry employment remained steady. During the past 12 months, more than 250,000 manufacturing jobs have been lost. In the services sector, government employment moved ahead by 75,000 due to hiring for the decennial census. The services industry added 50,000 jobs, mostly concentrated in health services. Retail trade employment declined for the second consecutive month, slipping 25,000 in March. Despite January's large gain in retail employment, the pace of job growth in the retail industry has been much slower than last year's pace.

Retail Sales Soften

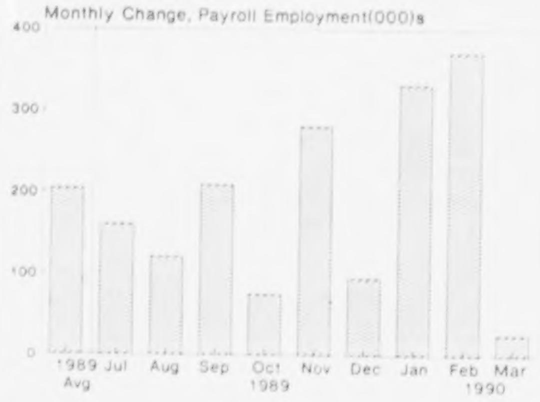
Retail sales fell 0.9 percent in February, after having risen a strong 2.8 percent during January. A plunge in auto dealer sales of 6.0 percent was mostly to blame for the February weakness. The decline in auto sales was the largest since January 1987 and effectively offsets the 9.9 percent surge in auto sales during January. Without the downward pull of auto sales, retail sales rose 0.5 percent. Retail sales in all other durable goods categories posted monthly increases, with non-auto durable goods sales up 1.3 percent. Non-durable goods sales also showed strength, rising 0.4 percent in February. This sales advance was widespread, but with more of the strength being concentrated in general merchandise and apparel stores, which registered increases of 2.0 and 1.6 percent, respectively.

GRAPH 1: THE ECONOMIC OUTLOOK



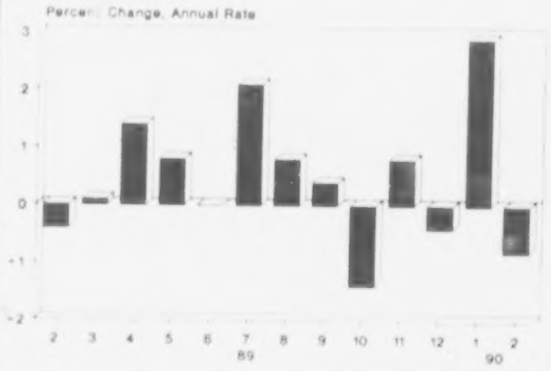
Source: Bureau of Economic Analysis; E - NAR estimates

GRAPH 2: PAYROLL EMPLOYMENT STALLS



Source: Bureau of Labor Statistics

GRAPH 3: RETAIL SALES LACKLUSTER



Source: Dept. of Commerce

Energy Prices Still Control Inflation Rate

The recent gyrations in the inflation rate, as measured by the consumer price index and the producer index, have largely been blamed on the vagaries of energy price movements. Yet again, this has proven to be the case, as energy prices fell and food price increases moderated. The net effect was an unchanged producer price index for finished goods, or rock solid prices at the producer level during the month of February. This is in marked contrast to the 1.8 percent jump in producer prices during January, which had many worried that the days of double digit inflation were back. In this month's producer price report, energy prices declined 5.0 percent (home heating oil plummeted 30.2 percent), and food prices rose only 0.9 percent. Excluding the volatile food and energy components, the producer price index rose 0.4 percent on price increases for most nondurable goods. The nonfood, nonenergy index for finished goods has risen at an annual rate of just under 4 percent since last August . At the intermediate good level of processing, prices fell 0.7 percent, again mainly due to energy prices. Net of energy and food components, the intermediate level price index rose 0.1 percent, while the crude level nonfood, nonenergy index fell 0.8 percent.

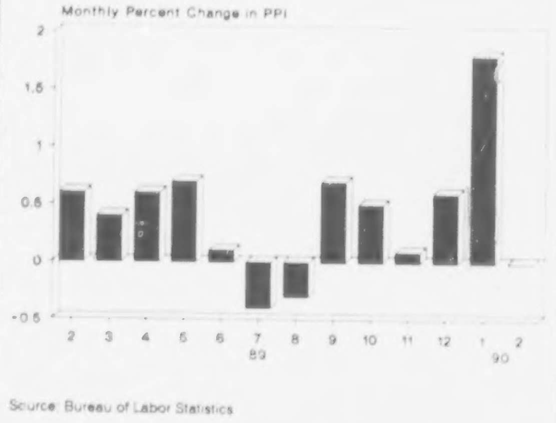
Trade Deficit Inches Up, Trend Remains Down

The U.S. merchandise trade deficit widened to $9.25 billion in January from an upwardly revised $7.68 billion in December. Imports jumped 7.3 percent in January, surpassing the 4.0 percent rise in exports. Exports rose to $32.07 billion, a record level, yet the 7.3 percent rise in imports brought imports to $41.32 billion. The $1.57 billion increase in the monthly trade gap was largely due to a record level of oil imports, which surged 44 percent. One reason for this, was the very cold December weather, which depleted oil supplies at many companies. While demand for oil will likely taper off from its January pace, dependence on foreign oil is still substantial: foreign oil accounts for more than 50 percent of U.S. oil consumption. The recent growing dependence on foreign oil is surprising, and threatens to erode much, if not all, of the improvements in the trade deficit which have been made during the past two years. In addition, slower rates of economic growth in many overseas markets will not help prospects for faster growth in U.S. exports, which in all likelihood means the trade deficit will not shrink much during 1990.

Interest Rates Are Stabilizing For Now

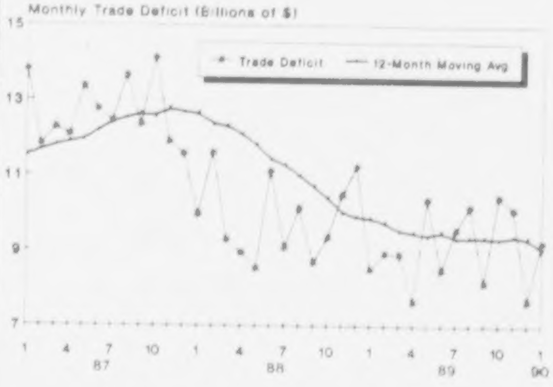
The confusing combination of monthly indicators on the economy's health has left many debating the next monetary policy move by the Fed. On the one hand, the Fed is being pressed to ease up on interest rates in the interest of avoiding a recession. On the other hand, there is just enough data on inflation to make the Fed cautious in its decision on whether to loosen monetary policy in order to give a boost to growth. Complicating the scene is the international wild card, wherein the Japanese stock market has plunged by record amounts and the U.S. dollar has shown uncanny strength. Until the confusion yields to more concrete data, count on the Fed to hold rates steady, with a preference toward slightly higher.

GRAPH 4: PRODUCER PRICES UNCHANGED



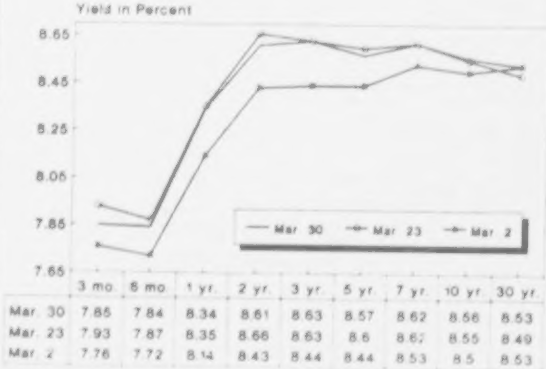
Source: Bureau of Labor Statistics

GRAPH 5: TRADE IMPROVEMENT STALLED?



Source: Dept. of Commerces

GRAPH 6: THE YIELD CURVE



	3 mo.	6 mo.	1 yr.	2 yr.	3 yr.	5 yr.	7 yr.	10 yr.	30 yr.
Mar. 30	7.85	7.84	8.34	8.61	8.63	8.57	8.62	8.56	8.53
Mar. 23	7.93	7.87	8.35	8.66	8.63	8.6	8.62	8.55	8.49
Mar. 2	7.76	7.72	8.14	8.43	8.44	8.44	8.53	8.5	8.53

Source: Federal Reserve

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

	Total	S-F	2-4	5 and up
Feb 1990	1477	1166	45	266
Jan 1990	1588	1109	56	423
Dec 1989	1273	931	53	289
Nov 1989	1347	1010	47	290
Oct 1989	1423	1023	60	340
Feb 1989	1465	1029	62	374

Feb 1990
Changes From (%):

	Total	S-F	2-4	5 and up
Jan 1990	-7.0	5.1	-19.6	-37.1
Feb 1989	0.8	13.3	-27.4	-28.9

REGIONAL DATA

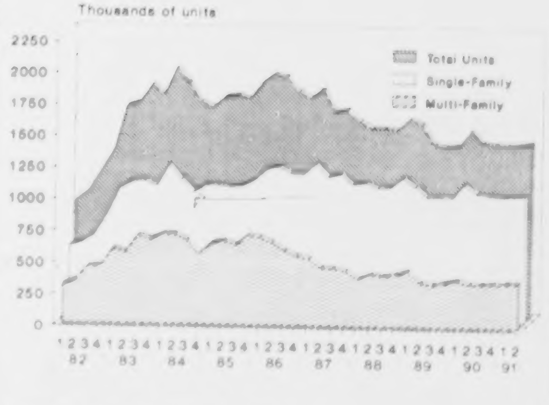
	Northeast	Midwest	South	West
Feb 1990	219	271	604	383
Jan 1990	176	382	526	504
Dec 1989	138	267	440	428
Nov 1989	179	296	498	374
Oct 1989	173	285	567	398
Feb 1989	224	273	572	396

Feb 1990
Changes From (%):

	Northeast	Midwest	South	West
Jan 1990	24.4	-29.1	14.8	-24.0
Feb 1989	-2.2	-0.7	5.6	-3.3

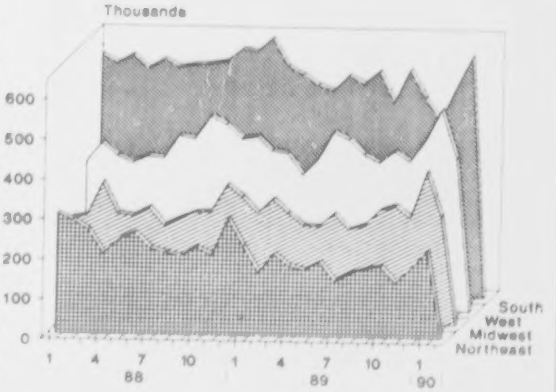
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

After surging in January, starts of privately owned housing units fell back in February to an annual rate of 1.477 million units, 7.0 percent below the January rate of 1.588 million units, but 0.8 percent above the February 1989 annual rate of 1.465 million units. A substantial decline in multi-family starts activity was to blame. However, the January pace was exaggerated by a rush to seek permits for structures under expiring federal guidelines, and continued warm winter weather. Starts of structures with 2-4 units plummeted to an annual rate of 45 thousand units in February, down 19.6 percent from the January 1990 rate of 56 thousand units, and down 27.4 percent from the February 1989 annual rate. Starts of structures with 5 or more units plunged to an annual rate of 266 thousand units in February, down 37.1 percent from the January 1990 rate of 423 thousand units, and 28.9 percent below the February 1989 annual rate. Starts of single-family units rose in February to an annual pace of 1.166 million units, up 5.1 percent from 1.109 million units in January, and up 13.3 percent from their year ago rate.

In the Northeast, starts rose 24.4 percent to a 219 thousand unit pace, and were down 2.2 percent from a year ago. In the South, starts rose 14.8 percent to 604 thousand units, and were up 5.6 percent from February 1989. In the Midwest, starts fell 29.1 percent to a pace of 271 thousand units, and were down 0.7 percent from a year ago. In the West, starts fell 24 percent to 383 thousand units, down 3.3 percent from a year ago.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Feb 1990	607	Jul 1989	738
Jan 1990	589	Jun 1989	647
Dec 1989	632	May 1989	653
Nov 1989	687	Apr 1989	607
Oct 1989	636	Mar 1989	555
Sep 1989	640	Feb 1989	621
Aug 1989	723		

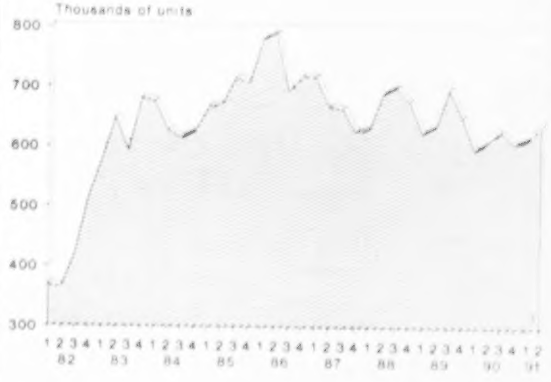
Feb 1990 Changes From:		Annual Totals:	
Jan 1990	3.1	1988	676
Feb 1989	-2.6	1989	650

REGIONAL DATA

	Northeast	Midwest	South	West
Feb 1990	82	88	256	181
Jan 1990	100	94	211	184
Dec 1989	91	87	252	203
Nov 1989	96	117	263	211
Oct 1989	88	101	271	176
Sep 1989	62	103	261	214
Feb 1989	83	103	238	199
1989	87	102	260	201
1988	101	97	276	202
Feb 1990 Changes From:				
Jan 1990	-18.0	-6.4	21.3	-1.6
Feb 1989	-1.2	-14.6	7.6	-9.0

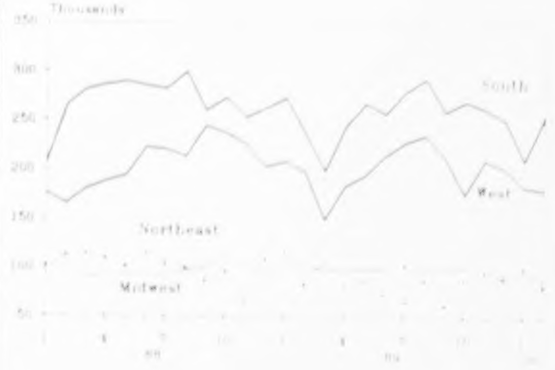
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

Sales of new single-family homes reached an annual rate of 607 thousand units in February, an increase of 3.1 percent above the January 1990 pace of 589 thousand units, but a decrease of 2.6 percent from their February 1990 annual sales rate of 621 thousand homes. The diminished availability of acquisition, development, and construction money, linked to provisions of the thrift bailout bill, continues to hamper growth in new home sales. Sales of new single-family homes are expected to recover somewhat from this lack of capital as builders identify and make use of additional sources of credit. However, this process may be complicated by the recent cutback in originations of real estate loans. Lately, many large regional banks have experienced a rising percentage of non-performing loans, many of which are real estate loans.

Sales of new homes in the Northeast fell to an annual rate of 82 thousand units, down 18 percent from the January pace of 100 thousand units, and down 1.2 percent from February 1989. In the Midwest, new home sales fell to 88 thousand homes, down 6.4 percent from January, and 14.6 percent below February 1989. In the South, sales rose 21.3 percent to an annual rate of 256 thousand units, and 7.6 percent above the February 1989 annual pace of 238 thousand units. In the West, new home sales slipped from an annual rate of 184 thousand units in January to an annual rate of 181 thousand units in February, and were 9 percent below a year ago.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Feb	1990	3440	Jul	1989	3330
Jan	1990	3520	Jun	1989	3360
Dec	1989	3560	May	1989	3210
Nov	1989	3590	Apr	1989	3400
Oct	1989	3480	Mar	1989	3400
Sep	1989	3520	Feb	1989	3480
Aug	1989	3480			

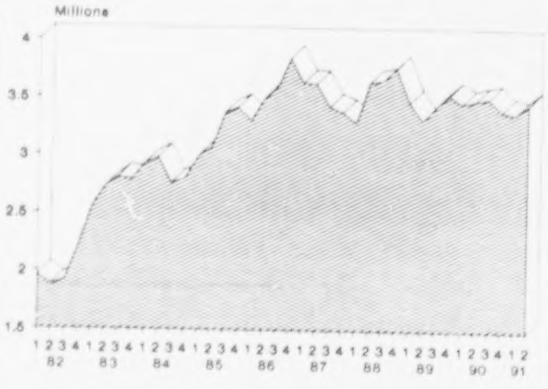
Feb 1990 Changes From (%):		Annual Totals:	
Jan 1990	-2.3	1989	3440
Feb 1989	-3.1	1988	3594

REGIONAL DATA

	Northeast	Midwest	South	West
Feb 1990	560	930	1310	650
Jan 1990	560	940	1400	570
Dec 1989	580	980	1390	610
Nov 1989	590	960	1430	640
Oct 1989	580	990	1300	620
Sep 1989	590	990	1340	590
Feb 1989	610	930	1350	650
1989	589	919	1307	610
1988	673	929	1350	642
Feb 1990 Changes From (%):				
Jan 1990	0.0	-1.1	-6.4	14.0
Feb 1989	-8.2	0.0	-3.0	0.0

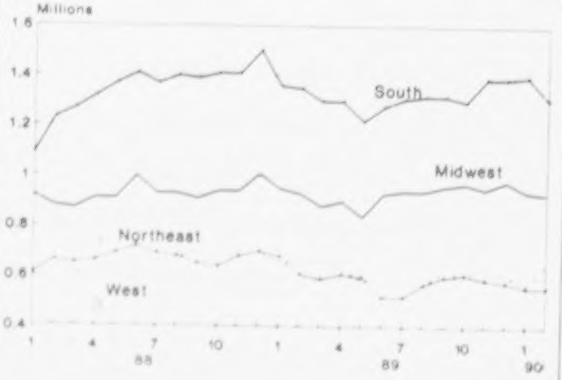
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

Sales of existing single-family homes eased slightly in February as slightly higher interest rates and a sluggish economy combined to soften housing demand in that month. Existing home sales slipped to an annual rate of 3.440 million units in February, a decrease of 2.3 percent from the January 1990 annual sales rate of 3.52 million units. The February 1990 sales rate was 3.1 percent below the 3.48 million annual rate of existing homes sales during February 1989. For the past seven months, the annual rate of existing single-family home sales has remained in a narrow range of between 3.44 and 3.59 million units. In contrast, new home sales have seemed to decline, albeit somewhat erratically during the same period. This pattern may continue for some time, particularly in light of the ADC loan crunch currently experienced by builders.

In the Northeast, existing home sales were flat in February at an annual rate of 560 thousand units, but were 8.2 percent below the February 1989 annual rate of 610 thousand units. In the Midwest, existing home sales fell 1.1 percent to an annual rate of 930 thousand units, from a January rate of 940 thousand units, but were unchanged from a year ago. In the South, existing home fell to an annual rate of 1.31 million units, down 6.4 percent from the January rate of 1.4 million units, and 3.0 percent below their year ago pace. In the West, sales reached a rate of 650 thousand units, 14 percent above the January pace of 570 thousand units, and unchanged from a year ago.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

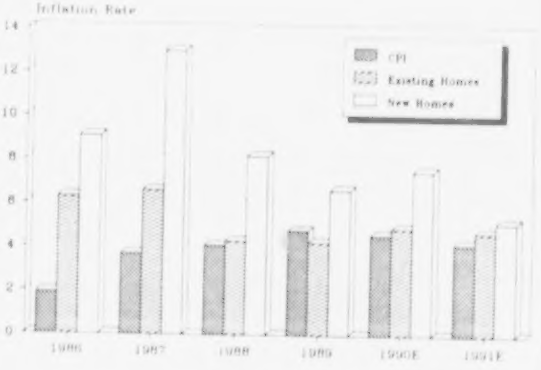
	Median Existing	Median New	Average Existing	Average New
Feb 1990	95,400	130,000	118,200	155,200
Jan 1990	96,300	125,000	120,000	154,200
Dec 1989	92,500	125,000	118,100	155,600
Nov 1989	93,200	125,000	118,300	151,400
Oct 1989	92,600	123,000	117,200	147,800
Feb 1989	91,800	118,000	117,900	145,300
1989	93,100	120,000	118,100	148,800
1988	89,300	112,500	112,800	138,300
Feb 1990 Changes From (%):				
Jan 1990	-0.9	4.0	-1.5	0.6
Feb 1989	3.9	10.2	0.3	6.8

REGIONAL DATA

	Northeast	Midwest	South	West
Feb 1990	143,400	73,800	85,600	143,100
Jan 1990	147,100	75,600	85,300	144,400
Dec 1989	143,400	72,500	82,700	135,200
Nov 1989	145,700	71,400	82,400	147,100
Oct 1989	143,200	71,600	83,600	142,300
Feb 1989	142,800	70,200	86,500	128,200
1989	145,200	71,300	84,500	139,900
1988	143,000	68,400	82,200	124,900
Feb 1990 Changes From (%):				
Jan 1990	-2.5	-2.4	0.4	-0.9
Feb 1989	0.4	5.1	-1.0	11.6

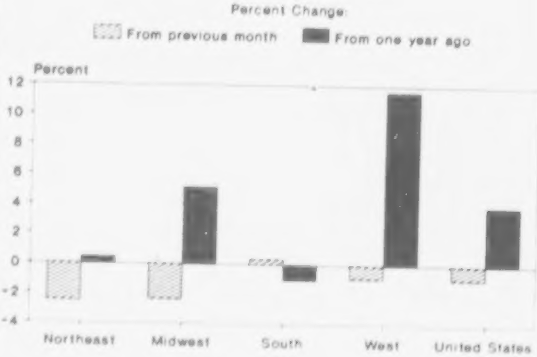
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The median sales price of an existing single-family home sold during February was $95,400, a decline of $900 from the January median price of $96,300. This was a decline of 0.9 percent from January, but it was 3.9 percent above the February 1989 median. The average price of an existing home sold during February was $118,200, a decline of $1,800 from the January average of $120,000. This marked a decline of 1.5 percent from January 1990 to February 1990, and an increase of 0.3 percent over the past twelve months. In the Northeast, the median price of an existing single-family home fell 2.5 percent to $143,400, and was 0.4 percent higher than a year ago. In the Midwest, the median price fell 2.4 percent to $73,800, but was 5.1 percent higher than a year ago. In the South, the median price rose 0.4 percent to $85,600, and was 1.0 percent below its year ago level. In the West, the median price fell 0.9 percent to $143,100, but was 11.6 percent higher than a year ago.

The median price of a new home rose 4.0 percent to $130,000 in February, and was 10.2 percent higher than a year ago. The average price of a new home rose 0.6 percent to $155,200 in February, and was 6.8 percent higher than a year ago.

Sean A. Burns
Director of Forecasting
Forecasting & Policy Analysis Division

U.S. ECONOMIC OUTLOOK

APRIL 1990

	QUARTERS											YEARS	
	ACTUAL		FORECAST						ACTUAL			FORECAST	
	89.3	89.4	90.1	90.2	90.3	90.4	91.1	91.2	1987	1988	1989	1990	1991
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5281	5340	5434	5509	5584	5662	5752	5855	4524	4881	5234	5547	5898
% Change	6.2	4.6	7.2	5.6	5.6	5.6	6.5	7.4	6.9	7.9	7.2	6.0	6.3
% Change (w/out inflation)	3.0	1.1	1.5	2.2	2.0	1.7	2.2	3.3	3.7	4.4	3.0	1.9	2.3
Consumer Price Inflation (CPI)	2.8	4.0	7.4	3.0	3.7	4.2	4.3	4.5	3.7	4.1	4.8	4.6	4.2
GNP Inflation (GNP Deflator)	3.2	3.2	5.8	3.3	3.6	3.8	4.3	4.0	3.1	3.3	4.2	4.0	3.9
Unemployment Rate - Civilian	5.3	5.3	5.3	5.4	5.5	5.6	5.6	5.6	6.2	5.5	5.3	5.5	5.6
Civilian Employment-Household Basis (millions)	117.5	117.8	118.1	118.2	118.5	118.7	119.0	119.4	112.4	115.0	117.3	118.4	119.6
Percent change	0.7	1.0	1.0	0.5	0.8	0.9	0.9	1.3	2.6	2.3	2.0	0.9	1.0
Index of Industrial Production	142.2	142.2	141.6	142.4	142.8	143.6	144.3	145.5	129.8	137.2	141.7	142.6	145.8
Manufacturing Capacity Utilization	84.0	83.0	82.2	82.2	81.9	82.3	82.7	83.2	81.0	83.5	83.9	82.2	83.2
Domestic Auto Sales	7.9	6.2	6.8	6.6	6.7	6.7	6.8	7.0	7.1	7.5	7.1	6.7	6.9
Federal Tax Receipts (NIPA) as % of GNP	19.8	19.8	20.1	20.2	20.3	20.3	20.4	20.4	20.1	19.9	20.0	20.2	20.3
Federal Expenditures (NIPA) as % of GNP	22.5	22.7	22.8	22.6	22.4	22.3	22.5	22.3	23.7	22.9	22.8	22.5	22.3
Deficit(NIPA)	-144.0	-156.0	-144.0	-127.0	-116.0	-112.0	-120.0	-113.0	-161.0	-145.0	-148.0	-125.0	-113.0
as % of GNP	-2.7	-2.9	-2.7	-2.3	-2.1	-2.0	-2.1	-1.9	-3.6	-3.0	-2.8	-2.3	-1.9
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4408	4501	4528	4484	4496	4376	4352	4444	4645	4646	4419	4471	4448
Percent change -- year ago	-6.0	-7.6	0.4	4.7	2.0	-2.8	-3.9	-0.9	-1.3	0.0	-4.9	1.2	-0.5
Existing Single-family Home Sales (thousands)	3443	3543	3470	3495	3515	3407	3380	3465	3526	3594	3440	[illegible]	3484
Percent change -- year ago	-6.0	-6.0	-2.2	-4.0	2.1	-3.8	-2.6	-0.9	-1.1	1.9	-4.3	[illegible]	0.4
Housing Starts (thousands)	1337	1347	1471	1370	1359	1353	1359	1374	1630	1491	1386	1388	1357
Percent change -- year ago	-9.1	-12.7	-2.3	1.2	1.7	0.4	-7.6	0.3	-10.0	-8.6	-7.0	0.2	-2.2
Single-Family Units	995	988	1091	1020	1011	999	1002	1009	1154	1085	1009	1030	994
Percent change -- year ago	-6.4	-12.4	2.6	2.9	1.7	1.1	-8.2	-1.1	-2.4	-5.9	-7.0	2.1	-3.5
Multi-Family Units	342	359	379	350	348	354	356	364	476	405	376	358	362
2-4 Family Units	56	53	56	51	51	52	52	54	65	58	55	53	53
Percent change -- year ago	-4.0	-15.3	-4.5	-2.7	-7.8	-1.5	-6.1	4.3	-22.9	-10.0	-5.7	-4.2	1.3
5 + Family Units	286	306	323	298	296	301	303	310	411	346	321	304	309
Percent change -- year ago	-18.2	-13.1	-15.4	-3.5	3.5	-1.5	-6.1	4.3	-24.5	-15.7	-7.3	-5.0	1.3
New Single-family Home Sales (thousands)	700	652	597	612	630	608	616	640	673	676	650	612	645
Percent change -- year ago	-0.5	-4.1	-12.7	-4.6	-6.9	-3.8	3.2	4.3	-9.6	0.4	-3.8	-5.9	5.4
Mobile Homes Shipped (thousands)	186	189	190	183	185	185	186	190	232	217	198	186	189
HOME PRICES													
Existing Home Prices - Median $(1000)	94.9	92.8	95.8	96.9	98.7	99.3	100.8	102.3	85.6	89.3	93.1	97.7	102.3
Percent change -- year ago	5.2	6.2	5.0	4.2	4.0	7.0	5.2	5.6	6.6	4.3	4.3	4.9	4.7
New Home Prices - Median $(1000)	119.6	124.3	128.9	126.7	129.0	131.5	131.0	132.0	104.5	112.5	120.0	129.0	135.7
Percent change -- year ago	4.1	9.7	9.1	6.5	7.9	5.8	1.6	4.2	13.6	7.7	6.7	7.5	5.2
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year Fixed Rate Mortgage (FHA Secondary)	10.0	9.8	10.1	10.0	9.8	9.8	9.8	9.9	10.2	10.3	10.3	9.9	10.0
1-year ARM (effective rate)	9.3	8.8	8.6	8.6	8.5	8.5	8.5	8.6	8.5	8.5	9.3	8.6	8.6
Corporate AAA Bond Rate	9.0	8.9	9.2	9.0	8.8	8.8	8.8	8.9	9.4	9.7	9.3	8.9	9.0
Government Bond Rate	8.1	7.9	8.4	8.2	8.0	8.0	8.2	8.5	8.6	9.0	8.4	[illegible]	8.5
Short-Term Interest Rates													
Federal Funds Rate	9.1	8.6	8.2	8.1	8.0	7.9	8.0	8.3	6.7	7.6	9.2	8.1	8.3
3-month T-Bill Rate	7.8	7.7	7.8	7.7	7.4	7.3	7.4	7.7	5.8	6.7	8.1	7.6	7.6
Prime Rate	10.7	10.5	10.0	10.0	9.8	9.7	9.8	10.0	8.2	9.3	10.9	9.9	10.1
Discount Rate	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	5.7	6.2	6.9	7.0	7.0
Value of the U.S. Dollar (Trade-Weighted Avg.)	100.5	97.3	93.1	93.7	92.8	91.7	90.5	89.7	96.9	92.8	98.5	92.8	89.9
Percent change	0.4	-12.2	-16.1	2.6	-3.8	-4.5	-5.4	-3.5	-13.6	-4.3	6.2	-5.8	-3.2

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy. Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE OUTLOOK

Vol. 3, No. 5

May 1990

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The U.S. Department of Commerce reported that the nation's real Gross National Product grew at a 2.1 percent annual rate in the first quarter, according to advance estimates. The higher than expected growth rate was only one of several surprises in the first quarter. A rapid acceleration in the rate of inflation during the late winter months, and a sharp rise in long-term interest rates also were widely regarded as surprise developments.
- The unemployment rate edged up to 5.4 percent in April. Payroll employment moved up by only 26,000, despite the inclusion of 80,000 temporary census workers. Manufacturing employment declined again in April, marking the twelfth monthly decline in the past thirteen months. This report seems to confirm that the industrial sector remains sluggish.
- Consumers faced slowly rising prices in April, a welcome respite from the torrid pace of consumer price inflation during the winter months. In April, the consumer price index for all urban consumers rose 0.2 percent. For the twelve month period ending in April, the consumer price index increased 4.7 percent.
- Starts of privately owned housing units dropped to an annual rate of 1.321 million units in March, 9.3 percent below the February annual rate of 1.457 million units. Starts of single-family units fell to 1.015 million units, 12 percent below the February annual rate of 1.154 million units.
- Sales of existing single-family homes remained unchanged in March at an annual rate of 3.4 million units, but were 0.9 percent slower than the rate of one year ago, when the annual rate of existing home sales reached 3.43 million units. The median price of an existing single-family home rose 0.9 percent in March 1990 to $96,100, while the median price of a new home fell 1.4 percent in March to $123,200, and was virtually unchanged from its March 1989 median price of $123,000.

IN THIS ISSUE

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RUBE GOLDBERG LIVES!
ECONOMIC COMMENTARY

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

Spring is here, the flowers are up, and so--unfortunately--are interest rates. The rate rise that started at the beginning of the year took most analysts by surprise (doesn't everything?!). Even more surprising is the persistence of the increase, especially in light of what is generally considered a soft economy. There are both real and psychological reasons for this, and there is both good and bad news about it.

First the good news--or, rather, the relatively good news. Rates have not yet risen to levels that prevailed as recently as a year ago. Of course, one might argue that this is the same as being less deep in a bog of quicksand, but there is some comfort here. Moreover, the recent GNP report for the first quarter of 1990 indicated that growth was lower than expected, and that will take some pressure off interest rates.

The bad news is that inflation terror has gripped the financial markets. Even though the "core" rate of inflation appears not to have moved from the 4-5 percent range it has occupied for the past six years, there is a widespread belief that the excessively high food and energy price increases of the first quarter are the norm and not an aberration. They were and inflation will prove to be moderate once again on 1990.

This psychology demonstrates the magic that the Federal Reserve holds over the economy. Analysts read growing inflation into the numbers, assume the Fed will raise interest rates, and then act to raise rates themselves. The Fed needs do nothing, since the market operates for them. This is a marvelous trick--in fact, it's the very thing parents have been searching for since time immemorial.

The real element fueling the rise in interest rates is another fascinating study in how the world has become a much smaller place, how interdependent national economies have become, and how a Rube Goldberg process of small actions adding up to totally unexpected results is an apt model for our times.

Interest rates in the United States are rising because of increases in interest rates in Germany and Japan. The transmission mechanism, of course, is the huge volume of U.S. Treasury securities trading in world financial centers.

In Germany, rates are rising in anticipation of unification. The tide of freedom that swept Eastern Europe was like a whirlwind courtship; German unification is waking up to your partner's "morning face" and realizing that the real task of building a relationship lies ahead. Specifically, the sharp differences in currency values between East and west means that any unification will inflate the economy of the West. Either there will be a leap in the purchasing power of the Eastern side, or there will be a transfer of real resources. In both cases, the Bundesbank will be forced to lean on the economy through credit restriction. So, rates are rising in anticipation.

In the Japanese case, we may have constructed our own Rube Goldberg machine. The U.S. has consistently applied pressure on the Japanese to loosen up their domestic economy and allow the consumption of more American goods. This has been, at least in part, successful. But this consumption has reduced the Japanese savings rate, increased the rate of growth, and put upward pressure on prices. Japanese policy-makers have chosen to counter this with a restrictive monetary policy that has collapsed the Tokyo Stock Exchange and raised interest rates. In turn, Japanese funds have flowed out of the U.S. Treasury market, forcing increases in our interest rates. So as Mouse (A) bites into Cheese (B) severing String (C), American home buyer takes it in Neck (D).

On balance, interest rates are not yet so high that they threaten to provoke inflation, nor shut down the housing sector. But the question remains as to whether they will crest and break, as they did in the second quarter of 1989. On the real side, the difficulties of our trading partners will continue in the near term, so there will be little relief from that quarter, unless the May meeting of the Group of Seven results in an agreement to cut interest rates. Relief, however, will come psychologically in the form of a recognition that the economy is growing slowly and that inflation is not really a problem. This will be strengthened by a clear tightening of monetary policy by the Fed as a signal that they will protect the economy even if it is a problem. When that takes hold, rates will drift downward, and the summer of 1990 will be a rerun of 1989.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The U.S. Department of Commerce reported that the nation's real Gross National Product grew at a 2.1 percent annual rate in the first quarter, according to advance estimates. Early in the year, analysts did not expect the first quarter number to be so strong, however, as the quarter progressed data emerged to suggest the economy was healthier than originally thought. The higher than expected growth rate was only one of several surprises in the first quarter. A rapid acceleration in the rate of inflation during the late winter months, and a sharp rise in long-term interest rates also were widely regarded as surprise developments. The strong GNP number was partly due to the natural disasters of last fall, the Boeing strike, and the wild swing in winter weather from a frigid December to an almost balmy January -- the net effect of which was to weaken the fourth quarter and strengthen the first quarter. Along the way, the long-term Treasury bond shot up from 7.85% in December to over 9% today. This rise in rates is more substantial and has lasted longer than originally predicted. The rapid acceleration in inflation during the late winter months did have much to do with sharp rises in food and energy prices, but there was also a moderate rise in the core rate of consumer price inflation. In the most recent report, however, this pressure seems to have eased somewhat. Despite this positive news on the inflation front, the combination of high interest rates and an economy that remains very weak in key areas (such as the industrial sector), means it is probably premature to speak of an economic rebound.

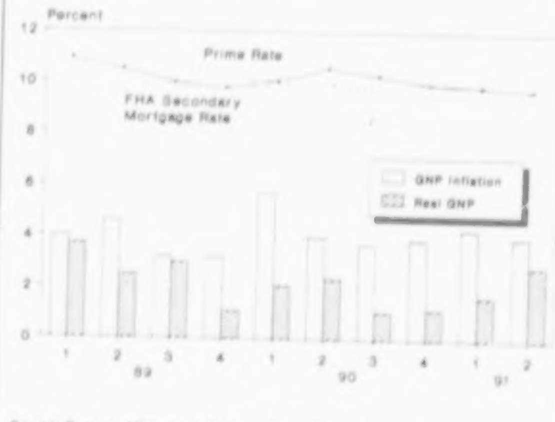
Employment Growth Slows

According to the latest monthly employment survey, the unemployment rate edged up to 5.4 percent in April. Payroll employment, a survey of nonfarm business establishments moved up by only 26,000, despite the inclusion of 80,000 temporary census workers. Manufacturing employment declined again in April, marking the twelfth monthly decline in the past thirteen months. This report seems to confirm that the industrial sector remains sluggish. However, other indicators, such as the April report from the National Association of Purchasing Managers, suggest a more rejuvenated industrial sector. Despite sectoral differences, labor markets in general are still very tight. This means that efforts to curb an acceleration in the rate of inflation would most likely require some period of below trend rates of GNP growth, which could lead to further modest rises in the unemployment rate.

Retail Sales Still Soft Nationally

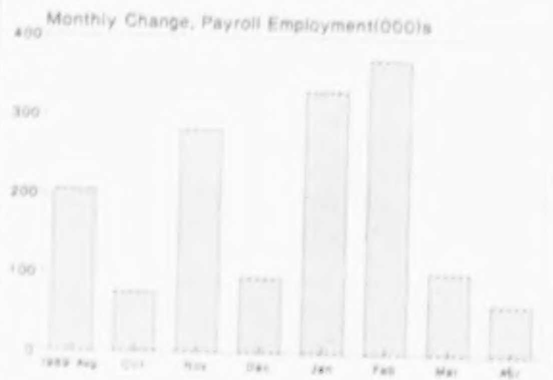
Retail sales declined 0.6% in April, largely due to a substantial 1.6% slide in sales of durable goods, and no growth in sales of nondurable goods. Retail sales have been i na slump for some time now: sales have declined five times in the last seven months. The softness in durable goods sales was fairly widespread. Auto sales slid 2.9 percent and building and garden materials dropped 2.6%. The only increase in durable goods sales was in furniture, which rose 0.4% and has shown significant gains in 1990, after posting almost no growth last year. Nondurable goods were weak in many areas as well, but this weakness was offset by gains at food and drug stores.

GRAPH 1: THE ECONOMIC OUTLOOK



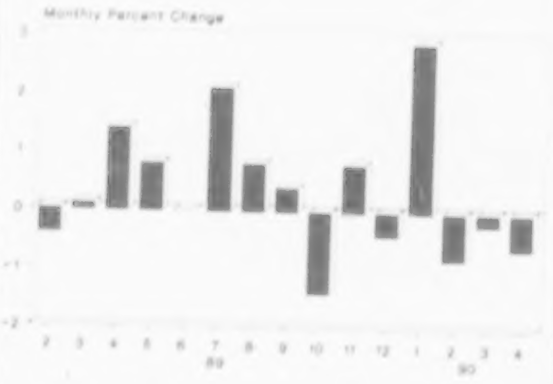
Source: Bureau of Economic Analysis; E - NAR estimates

GRAPH 2: PAYROLL EMPLOYMENT FLAT



Source: Bureau of Labor Statistics

GRAPH 3: RETAIL SALES STILL SOFT



Source: Dept. of Commerce

Inflation Eases at the Producer Level

Good news on the inflation front was announced recently by the Bureau of Labor Statistics, which reported that the producer price index for finished goods fell 0.3 percent in April. Producer prices slid 0.2 percent in March, and were unchanged in the month before. The decline in both March and April was due to large decreases in food and energy costs. If the food and energy components are netted out, then the producer price index rose 0.2 percent in April and 0.3 percent in March. These non-food,non-energy price increases were concentrated in capital equipment and miscellaneous consumer goods. Energy prices were lower in April for all stages of processing. Food prices rose 1.2 percent at the intermediate level of processing, but were down 0.8 percent at the crude level. The producer price indexes for manufacturing net output rose 0.4 percent in April, and the gain was broadbased. So far in 1990, the non-food,non-energy component of the producer price index has increases at an annual rate of 2.9 percent. This compares very favorably with last year during the same period, when producer prices for this component rose by an annual rate of 4.3 percent.

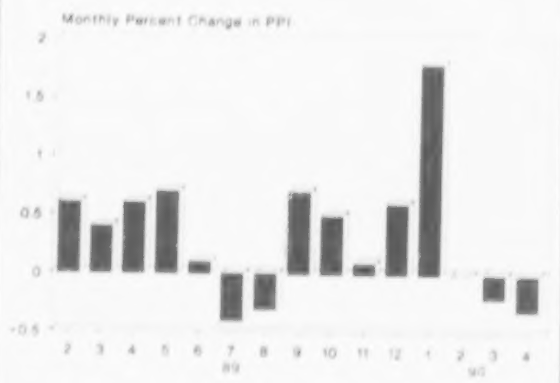
Consumer Prices Advance at a Slower Rate

At the retail level, consumers faced slowly rising prices in April, a welcome respite from the torrid pace of consumer price inflation during the winter months. In April, the consumer price index for all urban consumers rose 0.2 percent. This means that for the twelve month period ending in April, the consumer price index increased 4.7 percent. The April rise trails increases of 1.1 percent in January and 0.5 percent in both February and March. Though the slower advance was widespread among the many components of the consumer price index, the cooler rate of inflation was most evident in the same components most responsible for the sharp rise during the first quarter-- namely, the food, energy and apparel sectors. Food prices slid 0.2 percent in April, principally as a result of a plunge in fresh vegetable prices. Energy prices decreased in April for the third month in a row. The index for apparel and upkeep increased only slightly in April, after large gains in both February and March. The housing index increased 0.1 percent in April, after a substantial 0.5 percent advance in March. Shelter costs rose only 0.2 percent in April, after shooting up 0.7 percent in March.

Monetary Policy and Interest Rates

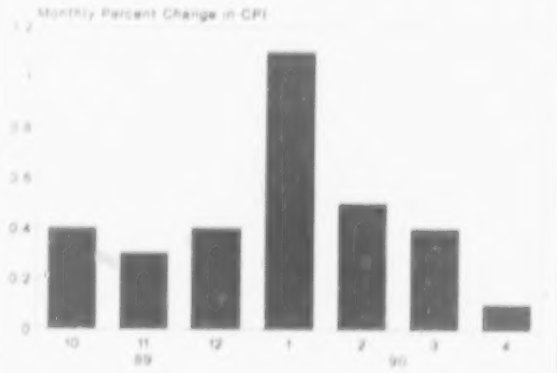
Much of the data on the opening month of the second quarter suggests a still slowly growing economy. Pressure will remain on the Fed to ease interest rates to allow the economy to move closer to its long-term trend rate of growth of about 2.5 percent. However, a competing concern of the Fed remains the value of the dollar and the level of foreign interest rates. The weakness of the dollar argues against anything more than a small decline in interest rates for the time being. Consequently, the Fed will likely keep the fed funds rate trading in the 8-8.25 percent range. If the economic data on May (due out beginning in early June) confirms a still weak economy, then the Fed could be expected to loosen further.

GRAPH 4: PRODUCER PRICES FALL



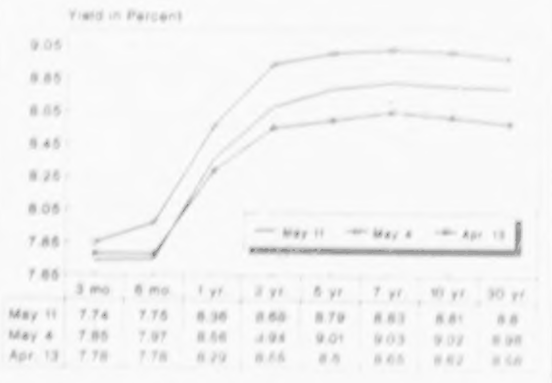
Source: Bureau of Labor Statistics

GRAPH 5: CONSUMER PRICES COOL OFF



Source: Bureau of Labor Statistics

GRAPH 6: THE YIELD CURVE



	3 mo.	6 mo.	1 yr.	2 yr.	5 yr.	7 yr.	10 yr.	30 yr.
May 11	7.74	7.75	8.36	8.68	8.79	8.83	8.81	8.8
May 4	7.85	7.97	8.56	8.94	9.01	9.03	9.02	8.98
Apr. 13	7.78	7.78	8.29	8.55	8.6	8.65	8.62	8.58

Source: Federal Reserve

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

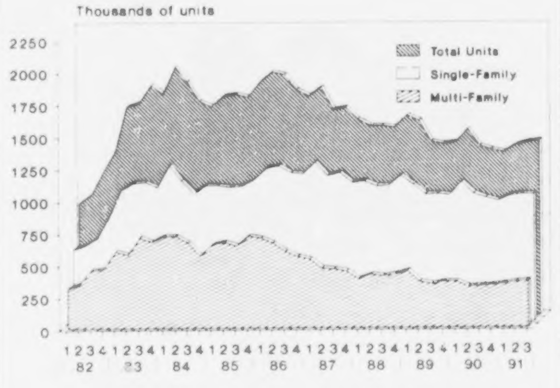
	Total	S-F	2-4	5 and up
Mar 1990	1321	1015	46	260
Feb 1990	1457	1154	44	259
Jan 1990	1568	1099	53	416
Dec 1989	1273	931	53	289
Nov 1989	1347	1010	47	290
Mar 1989	1409	981	50	378
Mar 1990 Changes From (%):				
Feb 1990	-9.3	-12.0	4.5	0.4
Mar 1989	-6.2	3.5	-8.0	-31.2

REGIONAL DATA

	Northeast	Midwest	South	West
Mar 1990	138	283	524	376
Feb 1990	222	265	592	378
Jan 1990	168	373	526	504
Dec 1989	138	267	440	428
Nov 1989	179	296	498	374
Mar 1989	160	308	552	389
Mar 1990 Changes From (%):				
Feb 1990	-37.8	6.8	-11.5	-0.5
Mar 1989	-13.8	-8.1	-5.1	-3.3

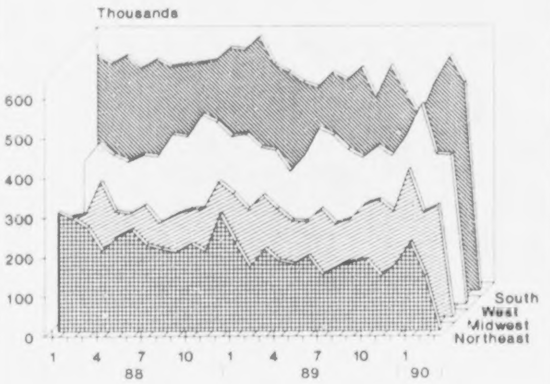
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Starts of privately owned housing units dropped to an annual rate of 1.321 million units in March, 9.3 percent below the February annual rate of 1.457 million units, and 6.2 percent below the March 1989 annual rate of 1.409 million units. Starts of single-family units fell to 1.015 million units, 12 percent below the February annual rate of 1.154 million units, but 3.5 percent above the March 1989 annual rate of 981 thousand units. Starts of multi-family structures with 2-4 units reached an annual rate of 46 thousand units in March, 4.5 percent above the February annual rate of 44 thousand units, but 8.0 percent below the March 1989 annual rate of 50 thousand units. Weakness in starts activity is expected to continue as builders are encountering capital scarce, due in large part to provisions of the thrift bailout plan.

By region, starts activity in the Northeast plunged in March to an annual rate of 138 thousand units, 37.8 percent below the February annual rate of 222 thousand units, and 13.8 percent below the March 1989 annual rate of 160 thousand units. In the Midwest, starts climbed 6.8 percent to an annual rate of 283 thousand units, but were 8.1 percent below their March 1989 annual rate of 308 thousand units. In the South, starts slid 11.5 percent in March to an annual rate of 524 thousand units, and were down 5.1 percent from their March 1989 annual rate of 552 thousand units. In the West, starts were virtually unchanged at an annual rate of 376 thousand units.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Mar 1990	574	Aug 1989	723
Feb 1990	604	Jul 1989	738
Jan 1990	613	Jun 1989	647
Dec 1989	633	May 1989	653
Nov 1989	687	Apr 1989	607
Oct 1989	636	Mar 1989	555
Sep 1989	640		

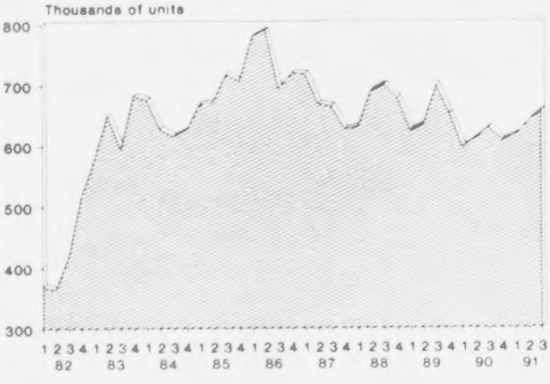
Mar 1990 Changes From:		Annual Totals:	
Feb 1990	-5.0	1988	676
Mar 1989	3.2	1989	650

REGIONAL DATA

	Northeast	Midwest	South	West
Mar 1990	99	95	219	161
Feb 1990	74	87	257	186
Jan 1990	96	104	228	186
Dec 1989	92	89	245	206
Nov 1989	96	117	263	211
Oct 1989	88	101	271	176
Mar 1989	107	99	200	150
1989	87	102	260	201
1988	101	97	276	202
Mar 1990 Changes From:				
Feb 1990	33.8	9.2	-14.8	-13.4
Mar 1989	-7.5	-4.0	9.5	7.3

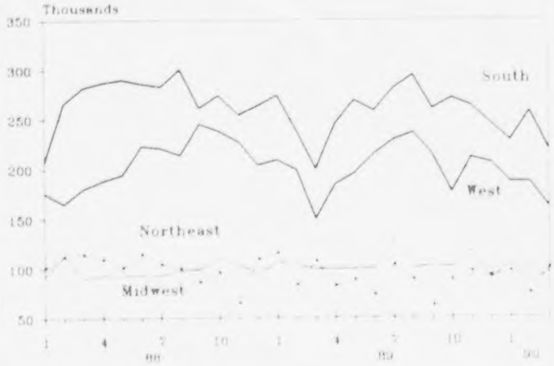
Source: Bureau of the Census; Construction Reports, Series C25

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

In March, sales of new single-family homes declined for the fourth consecutive month and the seventh downturn in the last eight months, and dipped below an annual rate of 600 thousand units for the first time since March 1989. New single-family homes sales slid to an annual rate of 574 thousand units, 5.0 percent below the February annual rate of 604 thousand units, but 3.2 percent above the March 1989 annual rate of 555 thousand units. Again, the lack of funds for home construction continued to depress new home sales, as did the continued problems with housing affordability.

In the Northeast, the annual rate of new home sales shot up to 99 thousand units, an increase of 33.8 percent from the February annual rate of 74 thousand units, but 7.5 percent below the March 1989 annual rate of 107 thousand units. In the Midwest, sales of new single-family homes crept up to an annual rate of 95 thousand units, or 9.2 percent faster than the February annual rate of 87 thousand units, but 4 percent slower than the March 1989 annual rate of 99 thousand units. In the South, new home sales fell to an annual rate of 219 thousand units, down 14.8 percent from the February annual rate of 257 thousand units, but 9.5 percent ahead of the March 1989 pace of 200 thousand units. In the West, new home sales declined to an annual rate of 161 thousand units, down 13.4 percent from the February annual rate of 186 thousand units, but 7.3 percent faster than the March 1989 annual rate of 150 thousand units.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Mar	1990	3400	Aug	1989	3440
Feb	1990	3400	Jul	1989	3380
Jan	1990	3520	Jun	1989	3330
Dec	1989	3560	May	1989	3250
Nov	1989	3560	Apr	1989	3440
Oct	1989	3490	Mar	1989	3430
Sep	1989	3510			

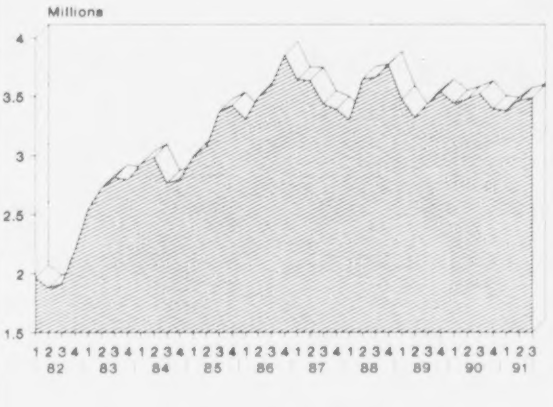
Mar 1990 Changes From (%):			Annual Totals:	
Feb	1990	0.0	1989	3440
Mar	1989	-0.9	1988	3594

REGIONAL DATA

		Northeast	Midwest	South	West
Mar	1990	490	890	1360	640
Feb	1990	560	890	1310	650
Jan	1990	560	940	1400	570
Dec	1989	580	980	1390	610
Nov	1989	590	950	1390	630
Oct	1989	610	970	1300	610
Mar	1989	590	880	1300	670
	1989	589	919	1307	610
	1988	673	929	1350	642
Mar 1990 Changes From (%):					
Feb	1990	-12.5	0.0	3.8	-1.5
Mar	1989	-16.9	1.1	4.6	-4.5

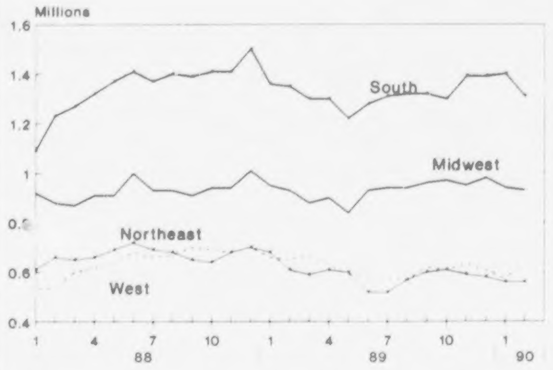
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

Sales of existing single-family homes remained unchanged in March at an annual rate of 3.4 million units, but were 0.9 percent slower than the rate of one year ago. when the annual rate of existing home sales reached 3.43 million units. The number of existing single-family homes available for sale at the end of the survey period stood at 2.34 million homes, up slightly from the month before, but somewhat lower of an inventory as compared to March 1989 when 2.43 million existing single-family homes stood available for sale.

By region, in the Northeast, existing single-family home sales fell to an annual rate of 490 thousand units in March, down 12.5 percent from February, and down nearly 17 percent from their annual pace in March 1989 of 590 thousand units. In the Midwest, the annual rate of sales of existing homes was unchanged in March at 890 thousand units, but when compared to one year ago, it was up slightly from the March 1989 annual rate of 880 thousand units. In the South, sales of existing homes rose to an annual rate of 1.36 million units in March, up 3.8 percent from the February annual rate of 1.31 million units, and 4.6 percent faster than the March 1989 annual rate of 1.3 million units. In the West, sales of existing homes slipped to an annual rate of 640 thousand units in March, a loss of 1.5 percent from the February annual rate of 650 thousand units, and 4.5 percent below the March 1989 annual rate of 670 thousand units.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

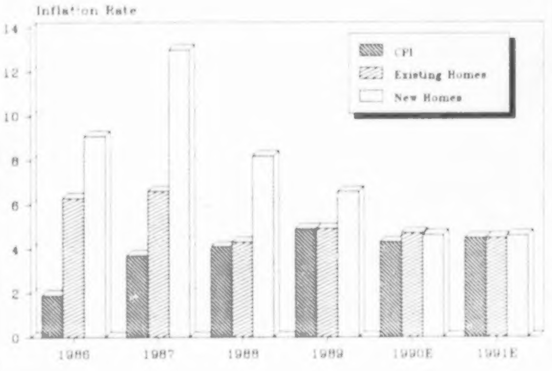
	Median Existing	Median New	Average Existing	Average New
Mar 1990	96,100	123,200	119,500	150,300
Feb 1990	95,200	125,000	118,300	149,200
Jan 1990	96,300	124,900	120,000	151,300
Dec 1989	92,500	125,200	118,100	154,300
Nov 1989	93,200	125,000	118,300	151,400
Mar 1989	91,900	123,000	116,300	149,000
1989	93,100	120,000	118,100	148,800
1988	89,300	112,500	112,800	138,300
Mar 1990 Changes From (%):				
Feb 1990	0.9	-1.4	1.0	0.7
Mar 1989	4.6	0.2	2.8	0.9

REGIONAL DATA

	Northeast	Midwest	South	West
Mar 1990	148,200	72,900	86,000	143,300
Feb 1990	143,400	74,100	85,200	143,300
Jan 1990	147,100	75,600	85,300	144,400
Dec 1989	143,400	72,500	82,700	135,200
Nov 1989	145,700	71,400	82,400	147,100
Mar 1989	143,600	69,900	83,700	138,100
1989	145,200	71,300	84,500	139,900
1988	143,000	68,400	82,200	124,900
Mar 1990 Changes From (%):				
Feb 1990	3.3	-1.6	0.9	0.0
Mar 1989	3.2	4.3	2.7	3.8

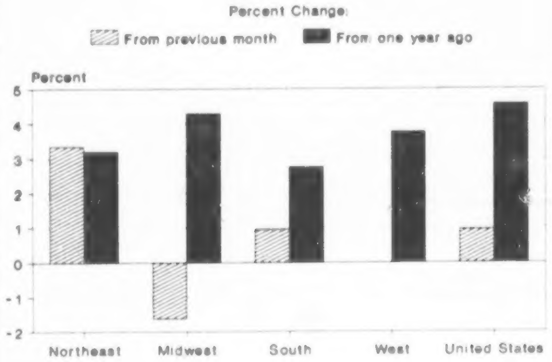
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The softness in housing demand is having the expected effect on housing prices, where price increases have slowed. The median price of an existing single-family home rose 0.9 percent in March 1990 to $96,100, while the average existing home price rose 1.0 percent to $119,500. Relative to one year ago, the median price of an existing home is now 4.6 percent higher, while the average price of an existing home is only 2.8 percent higher. By region, the median existing home price in the Northeast rose 3.3 percent in March to $148,200, which was 3.2 percent higher than the March 1989 median price of $143,600. In the Midwest, the median existing home price fell 1.6 percent to $72,900, but remained 4.3 percent above the March 1989 median price of $69,900. In the South, the median price of an existing home rose 0.9 percent in March to $86,000, and was 2.7 percent ahead of its March 1989 median price of $83,700. In the West, the median price of an existing home was unchanged in March at $138,100, but was 3.8 percent ahead of the March 1989 median price of $138,100.

The median price of a new home fell 1.4 percent in March to $123,200, and was virtually unchanged from its March 1989 median price of $123,000.

Sean A. Burns
Director of Forecasting
Forecasting & Policy Analysis Division

U.S. ECONOMIC OUTLOOK

MAY 1990

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	89.4	90.1	90.2	90.3	90.4	91.1	91.2	91.3	1988	1989	1990	1991	1992
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5340	5441	5528	5595	5665	5749	5847	5938	4881	5234	5557	5892	6283
% Change	4.6	7.8	6.5	4.9	5.1	6.1	7.0	6.4	7.9	7.2	6.2	6.0	6.6
% Change (w/out inflation)	1.1	2.1	2.4	1.1	1.2	1.7	2.9	2.2	4.4	3.0	1.9	1.9	2.5
Consumer Price Inflation (CPI)	4.0	8.1	3.4	4.0	4.4	4.3	4.5	4.6	4.1	4.8	4.9	4.3	4.5
GNP Inflation (GNP Deflator)	3.2	5.7	4.0	3.7	3.9	4.3	4.0	4.1	3.3	4.2	4.2	4.0	4.0
Unemployment Rate - Civilian	5.3	5.3	5.2	5.3	5.5	5.6	5.6	5.6	5.5	5.3	5.3	5.6	5.6
Civilian Employment-Household Basis (millions)	117.8	118.1	118.7	118.9	118.8	119.0	119.3	119.7	115.0	117.3	118.6	119.5	121.0
Percent change	1.0	1.0	2.3	0.5	-0.3	0.7	1.0	1.2	2.3	2.0	1.1	0.8	1.2
Index of Industrial Production	108.1	108.0	108.9	109.1	109.3	109.7	110.8	111.6	105.4	108.1	108.8	111.2	114.9
Manufacturing Capacity Utilization	82.9	82.4	82.5	82.3	82.2	82.4	82.7	82.8	83.9	83.9	82.3	82.7	83.2
Domestic Auto Sales	6.2	7.0	6.6	6.7	6.7	6.8	6.9	6.9	7.5	7.1	6.7	6.9	7.0
Federal Tax Receipts (NIPA) as % of GNP	19.8	20.0	20.2	20.2	20.3	20.3	20.3	20.3	19.9	20.0	20.2	20.3	20.3
Federal Expenditures (NIPA) as % of GNP	22.7	23.0	22.6	22.5	22.4	22.5	22.3	22.2	22.9	22.8	22.6	22.3	21.7
Deficit(NIPA)	-156.0	-161.0	-134.0	-128.0	-120.0	-127.0	-117.0	-111.0	-145.0	-148.0	-136.0	-114.0	-87.0
as % of GNP	-2.9	-3.0	-2.4	-2.3	-2.1	-2.2	-2.0	-1.9	-3.0	-2.8	-2.5	-2.0	-1.4
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4495	4496	4441	4454	4306	4328	4425	4451	4646	4419	4425	4403	4367
Percent change -- year ago	-7.8	-0.3	3.7	1.0	-4.3	-4.4	-1.3	-0.1	0.0	-4.9	0.1	-1.5	-0.8
Existing Single-family Home Sales (thousands)	3537	3440	3475	3520	3395	3380	3465	3490	3594	3440	3458	3446	3405
Percent change -- year ago	-6.2	-3.1	-4.6	2.2	-4.2	-2.6	-0.9	-0.9	1.9	-4.3	0.5	-0.7	-1.2
Housing Starts (thousands)	1347	1448	1316	1290	1271	1323	1349	1359	1491	1386	1331	1350	1406
Percent change -- year ago	-12.7	-3.8	-2.8	-3.5	-5.7	-8.6	2.5	5.4	-8.6	-7.0	-3.9	1.4	4.1
Single-Family Units	988	1089	996	963	939	977	990	991	1085	1009	997	986	992
Percent change -- year ago	-12.4	2.3	0.5	-3.2	-4.9	-10.2	-0.6	2.9	-5.9	-7.0	-1.2	-1.0	0.5
Multi-Family Units	359	359	319	326	331	345	358	368	405	376	334	363	413
2-4 Family Units	53	47	42	43	43	45	47	48	58	55	44	48	54
Percent change -- year ago	-15.3	-19.2	-20.4	-22.5	-17.6	-3.7	12.1	12.7	-10.0	-5.7	-20.0	8.7	13.8
5 + Family Units	306	311	277	283	287	300	311	319	346	321	290	315	358
Percent change -- year ago	-13.1	-18.6	-10.2	-0.9	-6.2	-3.7	12.1	12.7	-15.7	-7.3	-9.7	8.7	13.8
New Single-family Home Sales (thousands)	652	597	612	630	608	616	640	657	676	650	612	635	625
Percent change -- year ago	-4.1	-12.7	-4.6	-6.9	-3.8	3.2	4.3	4.3	0.4	-3.8	-5.9	3.8	-1.6
Mobile Homes Shipped (thousands)	189	198	200	191	185	191	194	195	217	198	193	194	197
HOME PRICES													
Existing Home Prices - Median $(1000)	92.7	95.9	96.9	98.7	99.3	100.8	102.3	103.1	89.3	93.1	97.7	102.3	106.9
Percent change -- year ago	6.2	5.0	4.2	4.0	7.0	5.2	5.6	4.5	4.3	4.3	4.9	4.7	4.5
New Home Prices - Median $(1000)	124.4	124.4	126.7	129.0	131.5	133.0	134.5	135.9	112.5	120.0	127.9	135.0	141.2
Percent change -- year ago	9.8	5.3	6.5	7.9	5.8	3.2	6.2	5.3	7.7	6.7	6.6	4.6	4.6
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-year Fixed Rate Mortgage (FHA Secondary)	9.8	10.1	10.6	10.3	10.0	9.9	9.8	9.8	10.3	10.3	10.3	9.8	9.4
1-year ARM (effective rate)	8.8	8.6	8.6	8.5	8.5	8.5	8.6	8.7	8.5	9.3	8.6	8.6	8.6
Corporate AAA Bond Rate	8.9	9.2	9.7	9.4	9.1	9.0	8.9	8.9	9.7	9.3	9.3	8.9	8.5
Government Bond Rate	7.9	8.4	8.9	8.7	8.4	8.3	8.3	8.3	9.0	8.4	8.6	8.3	7.9
Short-Term Interest Rates													
Federal Funds Rate	8.6	8.3	8.3	7.9	7.7	7.6	7.6	7.8	7.6	9.2	8.0	7.7	7.6
3-month T-Bill Rate	7.7	7.8	7.8	7.5	7.3	7.2	7.2	7.3	6.7	8.1	7.6	7.3	7.2
Prime Rate	10.5	10.0	10.0	9.7	9.5	9.5	9.5	9.5	9.3	10.9	9.8	9.5	9.3
Discount Rate	7.0	7.0	7.0	7.0	6.6	6.5	6.5	6.5	6.2	6.9	6.9	6.5	6.5
Value of the U.S. Dollar (Trade-Weighted Avg.)	97.3	93.1	93.5	92.9	90.5	88.9	87.8	87.5	92.8	98.5	92.5	87.9	87.0
Percent change	-12.2	-16.0	1.7	-2.6	-9.9	-7.0	-4.8	-1.5	-4.3	6.2	-6.1	-5.0	-1.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr Frederick Flick, and Sean Burns.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE OUTLOOK

Vol. 3, No. 6 *June 1990*

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The national economy grew at a 1.3% annual rate during the first quarter, according to the U.S. Department of Commerce. The figure is a significant downward revision of the government's earlier 2.1% estimate, made in late April. The primary reason for the slower rate of growth was that the level of business inventories fell further than had been thought earlier. With more sales out of inventories, the stage is set for inventroy rebuilding in the second quarter.
- The slowdown in the economy is particularly evident in the manufacturing sector, where employment has been cut back. For the twelve months ending in May 1989, about 300,000 jobs had been added to the nation's manufacturing payrolls. But by May 1990, however, this gain had been lost: Manufacturing employment recorded its thirteenth decline in the last fourteen months, with 311,000 workers displaced. Most of this weakness stems from the automobile market and related industries.
- One major source of the continued weakness in the economy is the Federal Reserve's efforts to curb inflation, which surged in the first quarter of 1990. Despite weakening demand in the economy, the Consumer Price Index grew at an 8.1 percent annual rate and the Producer Price Index topped that with a 9.1 percent annual rate.
- Starts of privately-owned housing units dropped to an annual rate of 1.245 million units in April. This pace is 5.8 percent below March's annual rate of 1.321 million units and 7.3 percent below the April 1989 annual rate of 1.343 million units. Relative to March's performance, starts of single-family homes bore the brunt of the decline, falling 7.5 percent, while the pace of starts for multi-family units remained the same.
- Sales of new homes declined for the fifth consecutive month in April, falling to an annual rate of 546,000 units. This marks a 21 percent decline in the sales rate since its recent November peak, and a 10.5 percent decline from its pace in April 1989. The sales rate for existing homes has also fallen from its peak in November, but by a less dramatic 7.2 percent.

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- Outlook for the Economy [illegible] Real Estate, by Robert D. [illegible]
- Asian Homeowners: A Growing Segment of the U.S. Housing Market
  -- by Lorraine Voss

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The Hole-in-the-Portfolio Gang Rides Again

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

Never play poker with a man named "Doc"....never eat at a place called "Mom's"....and never lay down with someone who has more problems than you. And now you can add to this mini-litany of rules to live by, "Never trust a bank regulator." The whole housing industry is in the grip of a credit crunch that has a little bit to do with risk, a little bit to do with economic sluggishness and a lot to do with the need for regulators to redeem themselves for falling asleep at the wheel in the Southwest.

There are two parts to this story, and if Perry Mason were on this, we'd call them "The Case of the Strangled Builder" and "The Case of the Performing Nonperforming Loan". In the first Case, the home building industry was found critically wounded, strangled with a cord bearing the initials "FIRREA", and lying under a sign that said, "No ADC loans!". Of course, Perry immediately figured out that this was a case of attempted manslaughter, took on the Federal bank regulators as a client, and turned to Paul Drake for an explanation.

By now Paul had given up the private eye business and taken a joint degree in politics and economics to pass the time. He basically explained that in an attempt to check the abuses that had created the thrift mess, Congress had, through FIRREA, extended to thrift institutions the loans-to-one-borrower limitation that had applied to commercial banks. The intent was to limit the risk exposure that thrifts could undertake and thus place a restriction on potential double-dealing.

Of course, as Paul (also an ardent environmentalist) observed, this fishing expedition caught dolphins as well as tuna and effectively shut down the supply of construction capital to significant sections of the home building industry. Small builders were generally unaffected because their credit needs fell within the limits; large builders could develop other sources of credit outside the depository system. Unfortunately, there were large numbers of firms that do not fit either of these categories and suffer from the loss of credit.

Drake finished his explanation by putting on his forecaster's hat and announcing to the hushed courtroom that he was revising downward his prediction of housing starts in 1990 and advising all his clients (including the NAR) to do the same. Having heard the evidence, the judge found the defendant guilty and sentenced the defendant to make restitution by developing a phase-in program so that this credit restriction would not continue to cripple homebuilding and thus the entire economy. At last report, the defendant was showing little signs of remorse. It is unclear if this judgment will be honored and the victim still clings feebly to life.

The second case was even more baffling to Perry since there were no eyewitnesses and testimony was in direct conflict. Again enter Drake who had discovered that the bank regulators were on a cross country tear. This was in fact the same gang that had turned a blind eye while the thrift industry was being looted by fast-buck artists. Only now they were trying to overcompensate for their past offenses by becoming zealots. And the witch hunt was focussed on real estate lending.

The M.O. was always the same: they'd enter a bank, force a markdown of any real estate loans, require the bank to increase its loan loss reserve, and blow town. If the bank wanted to question this hit, there was no real recourse. Even banks that had not been directly hit were fearful enough to cut off real estate lending and further cripple the industry. They were tied up in chains, but the kind of chains that you can't see (with apologies to the Cookies).

So far, Perry has not been able to crack this one. The alleged perpetrators have simultaneously denied guilt and pleaded self-defense. They were, they claimed, just saving the bank from the consequences when real estate loans went bad (as they *surely* would). The gang remains at large, and a trail of devastation from New England down the East Coast marks their progress.

Well, all this is a bit fanciful, but not very far off the mark. A real estate sector in which demand is strong, interest rates moderate, and profit potential good is being pushed into regional recession by the arbitrary actions of a bank regulatory establishment that has chosen to impose its own sackcloth and ashes on the industry. Having been burned badly by their own inattention in the Southwest, they now stalk the land like some modern group of Flagellants, preaching repentance to a captive audience.

The stories that have come out of New England suggest a massive regulatory devaluation of real estate loans that are current in payment and strong on collateral. The "nonperforming performing" loan has now entered the glossaries of the banking business, and when you look it up you'll see the picture of an investment real estate project.

Is this forever? No, but while it lasts, the real estate sector will be much weaker and will intensify any recessionary influences that may develop in the economy. And that's *not* the function of the Federal regulators. And the longer it persists, the more financial markets will take over the real estate financing function held by banks. The banks will be left with what seems to be the regulators' dream--a portfolio of liquid assets and short term, low interest rate deposits. Come to think of it, that sounds a great deal like the old Postal Savings System, doesn't it?

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The national economy grew at a 1.3% annual rate during the first quarter, according to the U.S. Department of Commerce. The figure is a significant downward revision of the government's earlier 2.1% estimate, made in late April. The primary reason for the slower rate of growth was that the level of business inventories fell further than had been thought earlier. With more sales out of inventories, the stage is set for inventory rebuilding in the second quarter.

Restocking inventories sold during the first quarter may be the only source of strength for the economy in the second quarter. Virtually every other component of demand -- personal consumption, business investment, residential investment, net exports and government spending -- appears weaker in the current quarter. Consumer spending on services remains healthy, in contrast to consumer spending on goods. Spending on big-ticket items appears to be especially weak in the second quarter, with a 3.4% annual rate of decline in overall durable goods spending projected. This includes a 9.6% annual rate of decline in automobile purchases. Business fixed investment is expected to decline at a 2.8% annual rate, and residential investment is expected to follow a healthy first quarter with a 4.2% annual rate of decline in the second quarter. Little change is expected in the level of net exports, and restraint -- particularly on the state and local levels -- characterizes growth in government spending.

For the year, real GNP is expected to grow 1.7%, after growing 4.4% and 3.0% in 1988 and 1989, respectively. Little improvement is expected in 1991, as real GNP is projected to grow 1.9%.

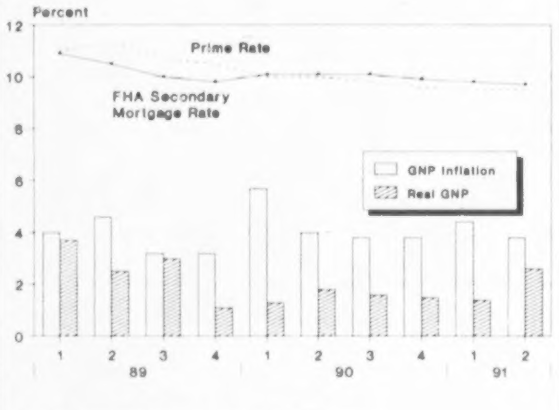
Consumer Spending on Durables Falls

With consumer expenditures making up about two-thirds of all spending in the economy, the health of the economy often rests with the consumer. Although incomes have been rising, purchasing power has been eroded by inflation, leading to a cutback in consumer purchases, particularly in big ticket items, as noted above. While the slowdown in the automobile sector has received a lot of press attention, consumers are also cutting back on other durable goods, items expected to last at least three years. The chart at right shows that slower consumer spending is not restricted to autos. The current weakness in the retail sales figures also indicates that consumers are wary.

Industrial Production Remains Sluggish

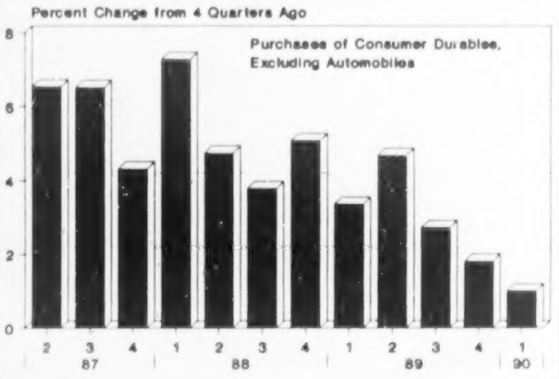
After propelling the economy through 1988 and most of 1989, the production of manufactured goods has slid over the past few months. Declining production of autos accounts for a large portion of the slowing growth rate, which is expected to recover modestly in the second half of the year. Relatively low inventories should prevent large cutbacks in many industries, and consequently the nation's overall production levels are not expected to actually decline. Industrial production should get a boost if, as expected, the exchange rate of the dollar resumes its decline in the second half of 1990. This would make U.S.-produced goods more competitive in world markets.

GRAPH 1: THE ECONOMIC OUTLOOK



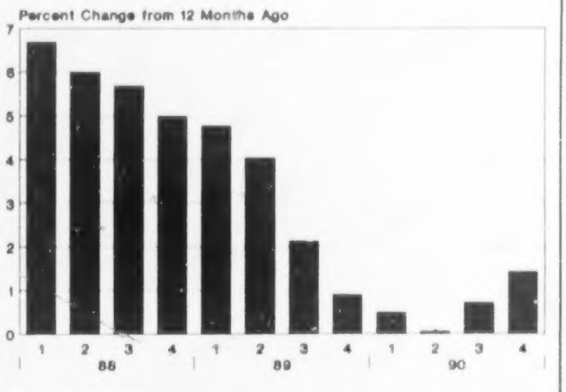
Source: Bureau of Economic Analysis; E NAR estimates.

GRAPH 2: CONSUMERS ARE MODERATING



Source: Department of Commerce

GRAPH 3: MANUFACTURING OUTPUT SLOWS



Source: Federal Reserve

Manufacturing Employment Hit Hard

The slowdown in the economy is particularly evident in the manufacturing sector, where employment has been cut back. In the twelve months ending in May, 1989, about 300,000 jobs had been added to the nation's manufacturing payrolls. But by May 1990, however, this gain had been lost: Manufacturing employment recorded its thirteenth decline in the last fourteen months, with 311,000 workers displaced. Most of this weakness stems from the automobile market and related industries.

Consumers apparently will not be providing any relief for autoworkers. Sales of domestically-produced autos in May ran at a 6.6 million annual rate, down slightly from April's rate. According to the forecast for 1990, fewer domestically-made cars will be sold -- about 6.8 million -- than in any year since the 1981-82 recession. By comparison, 7.1 million domestic autos were sold in 1989.

Employment growth in service industries, meanwhile, has remained robust. This has prevented a rise in the unemployment rate, which remains in the 5.3% to 5.4% range of the past 18 months. Rising wages that are not offset by improving productivity are expected to curtail the gains in employment over the next year, leading to a 5.9% unemployment rate by the second quarter of 1991.

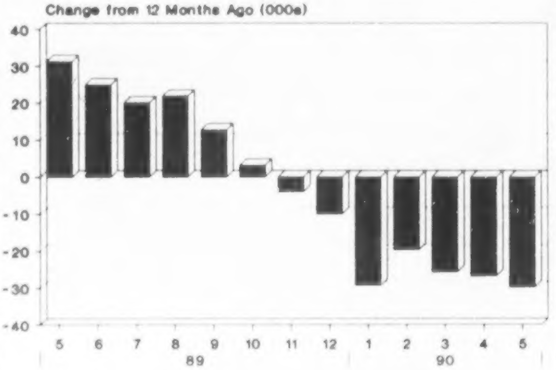
Productivity Growth Stalls

A more fundamentally serious problem in the current economic environment is the slowing growth in U.S. productivity. Graphed at right is the growth in nonfarm business productivity, which is expected to remain well below 1% during 1990. Since compensation is projected to grow about 5% in 1990, this productivity growth path implies an increase of about 4.5% in unit labor costs -- what producers pay to labor to produce one unit of output. Since labor is such a large share of total production costs, the steady growth in unit labor costs is one force contributing to inflationary pressure in the economy. Relief from this requires either lower compensation growth -- difficult when inflation is already outpacing wage growth -- or higher productivity.

Inflation Moderates a Bit But Remains Stubborn

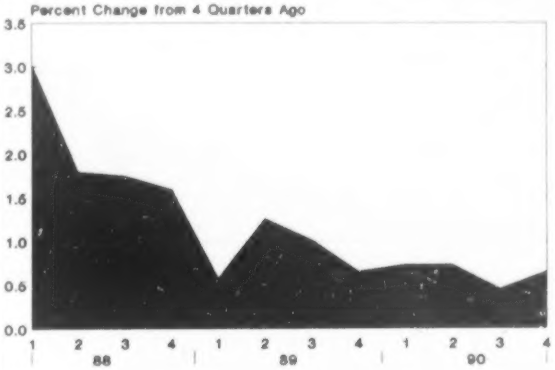
One major source of the continued weakness in the economy is the Federal Reserve's efforts to curb inflation, which surged in the first quarter of 1990. Despite weakening demand in the economy, the Consumer Price Index grew at an 8.1% annual rate and the Producer Price Index topped that with a 9.1% annual rate. For consumer prices, this was not simply related to the volatile food and energy components. Even after taking out these categories, which leaves the "core" rate of consumer inflation (solid line on the chart at right), the CPI nevertheless has jumped outside of the 4% - 5% band it has been growing at for the past five years. On the positive side, however, recent data indicates that inflation is unlikely to "break out" beyond the 5% annual rate. Nevertheless, it appears that the slowdown in the economy has had no significant impact on slowing inflation, at least so far. And, according to the forecast, it's not likely to. The CPI is projected to grow 4.9% in 1990 and 4.4% in 1991.

GRAPH 4: MANUFACTURING JOBS DISAPPEAR



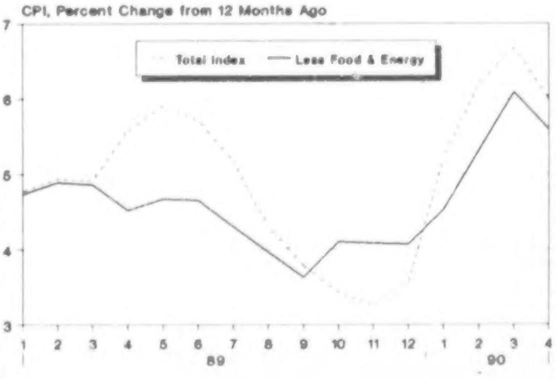
Source: Bureau of Labor Statistics

GRAPH 5: PRODUCTIVITY GROWTH SLIDES



Source: Department of Commerce

GRAPH 6: INFLATION STILL TROUBLING



Source: Bureau of Labor Statistics

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

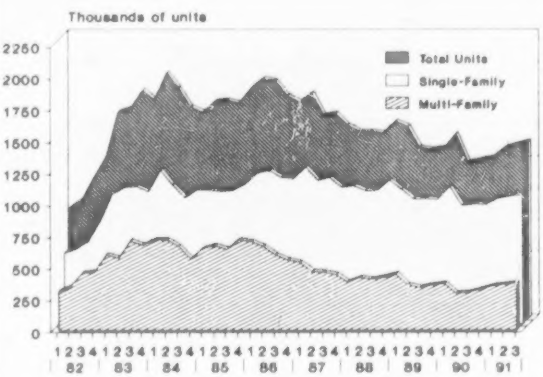
	Total	S-F	2-4	5 and up
Apr 1990	1245	934	48	263
Mar 1990	1321	1010	37	274
Feb 1990	1488	1154	42	292
Jan 1990	1568	1099	53	416
Dec 1989	1273	931	53	289
Apr 1989	1343	1029	62	252
Apr 1990 Changes From (%):				
Mar 1990	-5.8	-7.5	29.7	-4.0
Apr 1989	-7.3	-9.2	-22.6	4.4

REGIONAL DATA

	Northeast	Midwest	South	West
Apr 1990	127	298	480	340
Mar 1990	138	287	526	370
Feb 1990	224	293	581	390
Jan 1990	168	373	526	504
Dec 1989	138	267	440	428
Apr 1989	207	274	526	336
Apr 1990 Changes From (%):				
Mar 1990	-8.0	3.8	-8.7	-8.1
Apr 1989	-38.6	8.8	-8.7	1.2

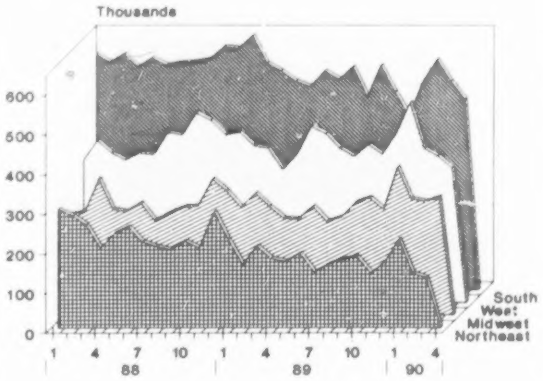
Source: Bureau of the Census; Construction Reports, Series C20

GRAPH 7: HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 8: HOUSING STARTS BY REGION



Source: Bureau of Census

Starts of privately-owned housing units dropped to an annual rate of 1.245 million units in April. This pace is 5.8 percent below March's annual rate of 1.321 million units and 7.3 percent below the April 1989 annual rate of 1.343 million units. Relative to March's performance, starts of single-family homes bore the brunt of the decline, falling 7.5 percent, while the pace of starts for multi-family units remained the same over the two months at 311,000 units. The seemingly impressive 29.7 percent gain for multi-family structures of 2-4 units comes off of a small base and follows declines of similar magnitude in earlier months. A better indicator of the health of the 2-4 unit housing segment is the 22.6 percent decline in starts over the past twelve months. Overall, starts of all multi-family units are down about 1 percent over the pace of a year ago. Weakness in starts activity is expected to continue as builders are encountering scarce capital, due in large part to provisions of the the thrift bailout plan.

The downturn is concentrated in the Northeast, where housing was started at a 38.6 percent slower pace in April 1990 than in April 1989. While the pace of U.S. housing starts between these two months is off by 98,000 units, the Northeast is off its year-ago pace by 80,000 units -- thus accounting for some 82 percent of the slower pace in the nation. The Southeast is also off its year-ago pace, but only by 8.7 percent. In April 1990, both the Midwest and the West were ahead of their April 1989 rate, by 8.8 percent and 1.2 percent, respectively. Relative to their starts rate in March, only the Midwest accelerated the pace of housing starts in April, by 3.8 percent.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Apr	1990	546	Sep	1989	640
Mar	1990	555	Aug	1989	723
Feb	1990	606	Jul	1989	738
Jan	1990	613	Jun	1989	647
Dec	1989	633	May	1989	653
Nov	1989	687	Apr	1989	607
Oct	1989	636			

Apr 1990 Changes From (%):			Annual Totals:	
Mar	1990	-1.6	1988	676
Apr	1989	-10.5	1989	650

REGIONAL DATA

		Northeast	Midwest	South	West
Apr	1990	105	92	203	146
Mar	1990	89	94	216	156
Feb	1990	66	84	267	189
Jan	1989	96	104	228	186
Dec	1989	92	89	245	206
Nov	1989	96	117	263	211
Apr	1989	82	99	245	184
	1989	87	102	260	201
	1988	101	97	276	202

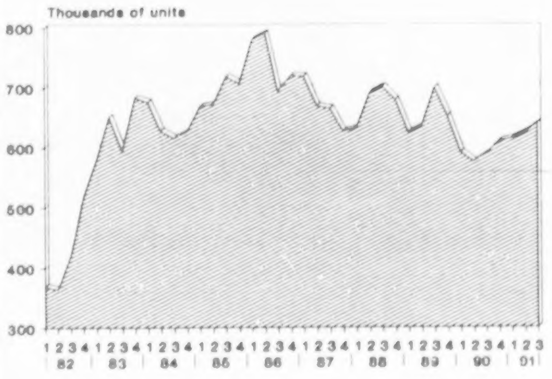
Apr 1990 Changes From (%):					
Mar	1990	18.0	-2.1	-6.0	-6.4
Apr	1989	28.0	-7.1	-17.1	-20.7

Source: Bureau of the Census; Construction Reports, Series C25

Sales of new homes declined for the fifth consecutive month in April, falling to an annual rate of 546,000 units. The 1.6 percent decline in April follows a revised 8.4 percent decline in March. This contributed to a 21 percent decline in the sales rate since its recent November peak and a 10.5 percent decline from its pace in April 1989. Sluggish economic growth, tightening credit availability, and declining affordability have all hurt new homes sales over the past several months.

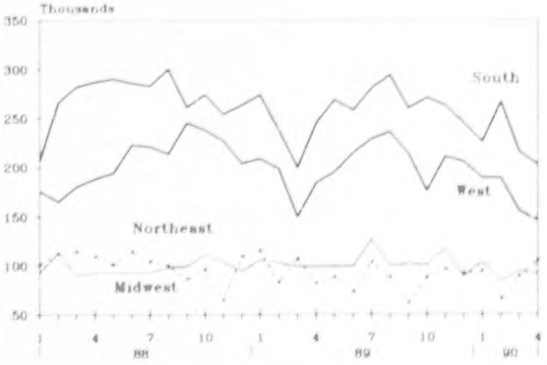
So far this year, new home sales are running at an average annual pace of 580,000 units, 10.8 percent below 1989's total of 650,000 units and 14.2 percent below 1988's total of 676,000 units.

GRAPH 9: NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

GRAPH 10: NEW HOME SALES BY REGION



Source: Bureau of Census

The Northeast built upon its 34.8 percent increase in March with an 18.0 percent increase in April. New homes were sold in the region at a 105,000-unit annual pace in April. This placed the region 28 percent ahead of its April 1989 sales rate. The April figures also show that the Northeast accounted for 19.2 percent of all U.S. new home sales, up from its 1989 share of 13.4 percent.

The other three regions experienced declines in the sales rate during April. The West was off 6.4 percent relative to March, the South dropped 6.0 percent, and the Miidwest declined 2.1 percent. In comparison to year-ago figures, the West was off by 20.7 percent, the South by 17.1 percent, and the Midwest by 7.1 percent.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

NATIONAL DATA

Apr	1990	3330	Sep	1989	3520
Mar	1990	3400	Aug	1989	3480
Feb	1990	3400	Jul	1989	3330
Jan	1990	3520	Jun	1989	3360
Dec	1989	3560	May	1989	3210
Nov	1989	3590	Apr	1989	3400
Oct	1989	3480			

Apr 1990 Changes From (%):			Annual Totals:	
Mar	1990	-2.1	1989	3440
Apr	1989	-3.2	1988	3594

REGIONAL DATA

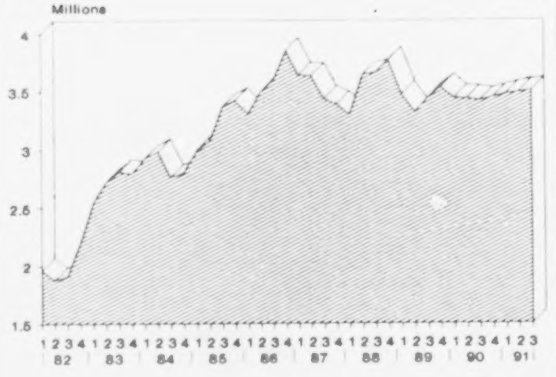
		Northeast	Midwest	South	West
Apr	1990	520	900	1310	580
Mar	1990	500	910	1360	630
Feb	1990	560	890	1310	650
Jan	1990	560	940	1400	570
Dec	1989	580	980	1390	610
Nov	1989	590	960	1430	640
Apr	1989	610	900	1300	630
	1989	589	919	1307	610
	1988	673	929	1350	642
Apr 1990 Changes From (%):					
Mar	1990	4.0	-1.1	-3.7	-7.9
Apr	1989	-14.8	0.0	0.8	-7.9

Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

As with new home sales, the annual rate of existing home sales has failed to increase for the fifth consecutive month. The decline in the sales rate over this period is less dramatic for existing homes, which have fallen 7.2 percent since November, than for new homes, which have fallen 21 percent. In April, existing home were sold at a 3.33 million annual rate, 2.1 percent below March's 3.40 million rate. Sales in April were off by 3.2 percent from its year-ago level.

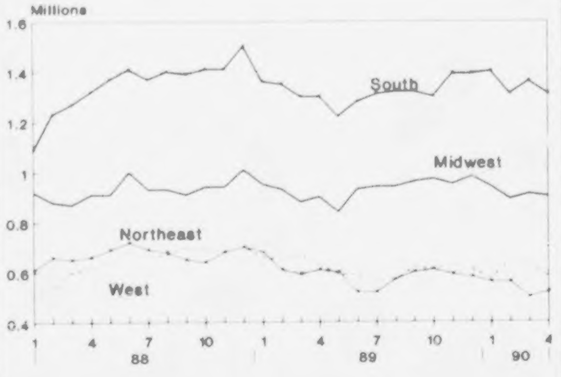
The supply of existing homes on the market shot up 10.8% during the month, leaving 2.56 million existing homes available for sale. This places the inventory of existing homes 2.0 percent higher than at the end of April 1989.

GRAPH 11: EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

GRAPH 12: EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

A 4.0 percent increase in existing home sales may mark the beginning of a rebound in the Northeast. Existing homes were sold at a 520,000-unit annual rate during April, up from March's 500,000 rate. The region's weakness is still shown in the 14.8 percent decline in sales activity over the past twelve months.

The other three regions experienced declines in the sales rate during April. The West dropped 7.9 percent to 580,000 units, the South fell 3.7 percent to 1,310,000 units, and the Midwest slipped 1.1% to 900,000 units. Relative to a year ago, the sales rate dropped 7.9 percent in the West and 0.8 percent in the South. The sales rate in the Miidwest remained unchanged from its April 1989 level.

SINGLE-FAMILY HOME PRICES

(In Dollars)

NATIONAL DATA

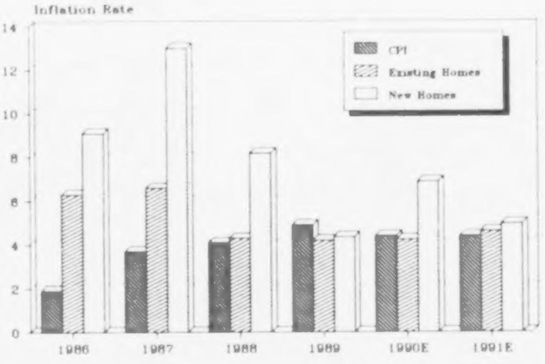
		Median		Average	
		Existing	New	Existing	New
Apr	1990	95,300	135,900	116,400	160,200
Mar	1990	96,300	119,400	119,500	144,100
Feb	1990	95,200	125,200	118,300	150,100
Jan	1990	96,300	125,000	120,000	151,700
Dec	1989	92,500	125,200	118,100	154,300
Apr	1989	92,900	116,700	117,900	144,700
	1989	93,100	120,000	118,100	148,800
	1988	89,300	112,500	112,800	138,300
Apr	1990				
Changes From (%):					
Mar	1990	-1.0	13.8	-2.6	11.2
Apr	1989	2.6	16.5	-1.3	10.7

REGIONAL DATA

		Northeast	Midwest	South	West
Apr	1990	140,700	75,300	85,700	134,900
Mar	1990	148,800	73,500	86,000	141,800
Feb	1990	143,400	74,100	85,200	143,300
Jan	1990	147,100	75,600	85,300	144,400
Dec	1989	143,400	72,500	82,700	135,200
Apr	1989	144,000	70,400	85,300	141,100
	1989	145,200	71,300	84,500	139,900
	1988	143,000	68,400	82,200	124,900
Apr	1990				
Changes From (%):					
Mar	1990	-5.4	2.4	-0.3	-4.9
Apr	1989	-2.3	7.0	0.5	-4.4

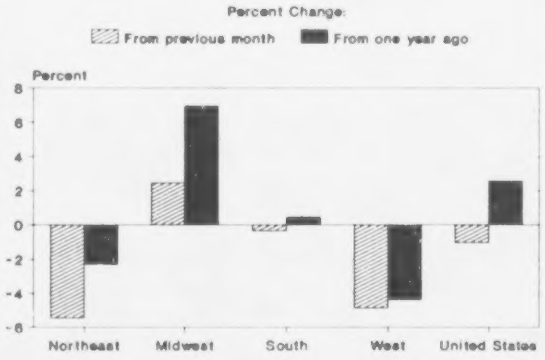
Source: NATIONAL ASSOCIATION OF REALTORS®
Economics and Research Division

GRAPH 13: HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

GRAPH 14: HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The median price for existing homes slipped 1.0 percent during April to $95,300, reflecting the sluggishness of the housing market. Relative to a year ago, the median price has risen $2,400, or 2.6%. The median price fell the furthest in the Northeast, where in April the median price hit $140,700, a drop of $8,100 from its level in March. This decrease of 5.4 percent was almost matched by the West's 4.9 percent decline to $134,900. The South experienced a modest decline of 0.3 percent to $85,700, while in the Midwest the median price grew by $1,800 to $75,300, a gain of 2.4 percent.

The dramatic 13.8 percent increase in the median price of new homes during April indicates the thinness of the housing market for lower-priced new homes. The median price, $135,900, stands 16.5 percent above its year-ago level.

The average prices displayed much the same pattern as the median prices: While the average price of new homes rose sharply, the average price of existing homes dipped. The average new home price was $16,100 higher in April than it was in March, an increase of 11.2 percent. For existing homes, the average price fell by $3,100, a decline of 2.6 percent.

Robert D. Barr
Forecasting & Policy Analysis Division

Asian Homeowners: A Growing Segment of the U.S. Housing Market

Just within the past couple of years, Asians have become the nation's fastest-expanding ethnic minority. Though Asians still number only around 5 million, or 2 percent of the total U.S. population, their ranks have been swelling at an unprecedented rate since the reform of immigration laws in 1965. Last year alone, more Asian immigrants came to the U.S. than in the three decades from 1931 to 1960. More than half settled in California, which has the nation's largest Asian population. The flood of new arrivals is not likely to diminish in the foreseeable future. About 1 million Asians have already applied and received preliminary clearance to come to America. Taking into account natural increase (birth minus deaths) and continuing immigration, by the year 2010, the Asian population in the U.S. is expected to more than double.[1]

Like other ethnic immigrants before them, Asians perceive homeownership as an important milestone in their assimilation. The number of foreign-born homebuyers is gradually increasing as immigrants who came here 5 to 10 years ago are becoming financially stable. And, those that will be arriving in the first part of the 90's will be ready to buy within the next decade. As Asian immigrants become more settled in their new homeland, they will become increasingly important players within the real estate market.

Asian Arrivals to the U.S.

There has been a constant flow of Asians migrating to the U.S. for more than a century. (See Table 1). According to the 1980 Census, over 95 percent of all Asian-Americans came from or had ancestors from China, Phillipines, Japan, India, Korea and Vietnam. More recently, people from the Philippines, China, India, and Korea have come in growing numbers. A surge of refugees arrived in the U.S. in 1975 after the fall of Saigon. Thousands more refugees came from Cambodia and Laos. Other than refugees, other immigrants have been businesspeople, tourists and students who adjusted to permanent resident status without having to leave and re-enter the U.S. Most of Asian immigration now is from students and from those who want to join family members who have already migrated to the U.S.

The 1965 immigration law abolished the national origins quota system, replacing it with a system giving preference to family members of persons already in the U.S. and workers with skills needed in the U.S. Under the new system, the number of Asian immigrants to the U.S. increased dramatically. For the Eastern hemisphere, the annual quota was set at 170,000 with no more than 20,000 from any one country. This is a substantial portion of the world wide annual quota of 270,000 with 20,000 from any one country. Also admitted beyond this numerical limitation are spouses, parents, and unmarried children under the age of 21 of U.S. citizens plus refugees. By 1981, some 60 percent of the Asian immigrants admitted to the U.S. came outside the numerical limitations.[2]

Table 1

MAJOR COUNTRIES OF ANCESTRY FOR ASIAN-AMERICAN, 1980, 1985 AND PROJECTIONS FOR 1990 AND 2000

Ethnic Group	1980	1985*	1990	2000
Chinese	23.4%	21.0%	19.3%	17.1%
Filipinos	22.6	20.4	21.5	21.0
Japanese	20.6	14.9	12.4	8.7
Asian Indians	11.2	10.2	10.4	10.2
Koreans	10.3	10.5	12.4	13.4
Vietnamese	7.1	12.3	13.1	26.0
TOTAL	**95.3**	**89.3**	**89.3**	**86.4**

*Estimates for September 30, 1985

SOURCE: U.S. Bureau of the Census, Statistical Abstract of the United States: 1989 (109th edition) Washington, D.C., 1989, Table 45 p. 39; Robert W. Gardner, Bryant Robey, and Peter C. Smith, Asian Americans: Growth, Change, and Diversity, Vol. 40, No. 4 (Washington, D.C.: Population Reference Bureau, 1985), Table 1; and Leon F. Bouvier and Anthony Agresta, "The Future Asian Population of the United States," in James T. Fawcett and Benjamin V. Carino (eds.), Pacific Bridges: The New Immigration from Asia and the Pacific Islands (Staten Island, New York: Center for Migration Studies of New York, Inc., 1987), Table 12.2, p. 292.

Estimating the growth of the Asian population in the United States is an inexact science. So much depends on the vagaries of immigration policies and diplomatic ties between nations. Projections made 20 years ago are not accurate today because few analysts could account for the impact of the 1965 immigration law changes or the impact of the Vietnam war.

Not only is information on future trends for Asian immigrants tentative, but data on their current living and working conditions is sketchy, as well. Some evidence is available from the 1980 Census, but this is obviously an inadequate source of information for the bulk of new immigrants. Further, the 1980 Census does not differentiate between new Asian immigrants and Asians who have been in the country for generations. Information on Asians in the work force, education trends, discrimination, and their economic status has been compiled by the U.S. Commission on Civil Rights in The Economic Status of Americans of Asian Descent: An Exploratory Investigation. The sources of this publication however, have also been derived from the data available in the 1980 Census, so the data are somewhat dated and do not represent the current status of Asians that migrated to the United States during the decade of the 80's. The 1987 American Housing Survey provides some indication of the housing conditions of Asians in the United States. However, the main problem with this data source is that like the 1980 Census, it does not differentiate between new Asian immigrants and Asian-Americans. Thus, there are considerable gaps in our knowledge about how Asian immigrants are faring in their new country.

Asian Earning Power

For recent Asian immigrants, economic adjustment to life in the U.S. seems to rely on strong family support. Observers of Asian success suggest that their considerable reliance on family leads to rapid self sufficiency. It is common within Asian immigrant families to pool resources for housing particularly in their first years in the U.S. The 1980 Census shows that the households of the most recently arrived immigrants include much higher proportions of relatives compared to Asian-Americans in general. Of these families where two or more are working, only 7 percent fall below the poverty level.[3] The pattern is for family members to move out on their own once they become self-supporting.

Geographically, Asian immigrants are concentrated in urban areas. They reside in disproportionate concentrations in the Northeast and the West, especially California and Hawaii. California ranks first for both Asians and Americans in general, but in 1980, 36 percent of all Asian immigrants lived there, compared to 10 percent of the total U.S. population. The difference was even greater in Hawaii. Nearly half the population of Hawaii is Asian.[4]

Most immigrants flock to cities and Asians are no exception. Among the six major Asian groups, 92 percent lived within Metropolitan Statistical Area boundaries in 1980, compared with 75 percent of the total U.S. population. As they become more established in the U.S., like immigrants in the past, the Asian population will most likely gradually move out of the cities.

Because Asians are residing primarily in high cost of living areas, they tend to have higher nominal earnings. The U.S. Commission on Civil Rights reports that the average family incomes of most Asian groups in 1980 exceeded the average income of U.S. families. An examination of the figures suggests some of the reasons.

Most Asian immigrants have a higher level of education than the U.S. average, but like other minorities and immigrants before them, they are found disproportionately in the low-paying service occupations. However, unlike other minorities, they are also concentrated at the top of the occupational hierarchy in professional, managerial and executive positions. For example, in 1980, 24 percent of employed Americans held jobs as managers, professionals, or executives, but the proportion of foreign-born Asian Americans in this high-status category was much higher. Those Asians holding professional positions are broken down as follows: 26 percent for Filipinos, 28 percent for Japanese, 30 percent for Chinese, and 47 percent for Asian Indians.[5] The figures were only lower for Koreans and Vietnamese. The lower income for Koreans may be due to the fact that they primarily went into their own grocery business, like those who work street corners in New York or Los Angeles. As for the Vietnamese, a good portion are refugees who are generally less educated and work as farmers speaking little English.

Asian earning power has risen faster than any prior surge of immigrants to the U.S.[6] An important factor underlying higher Asian family incomes is the added work efforts from wives. Not only are Asian women more likely to work than U.S. women on average, they tend to earn more, as well. Table 2 indicates that except for Japanese-Americans, almost all Asian women are as likely or more likely to participate in the labor force as compared to U.S. women. Among Filipino-Americans, almost 85% of married women work. The average incomes of Filipino and Korean-American women exceed the average income of U.S. women by

Table 2

SOCIAL & ECONOMIC BACKGROUND, 1980

	Chinese	Filipino	Japanese	Indian	Korean	Vietnamese
Income*						
Average family income	22,560	23,690	27,350	24,900	20,460	12,840
% of U.S. avg.	0.99	1.11	0.95	1.15	0.94	0.60
Asian Women*						
% in work force	65	83	27	51	61	54
Income relative to U.S. avg.	1.12	1.59	1.26	1.11	1.22	0.94

*Foreign-born

SOURCE: U.S. Commission on Civil Rights, The Economic Status of Americans of Asian Descent: An Exploratory Investigation, 1988.

almost 50 and 30 percent respectively.

Among four of the six Asian groups, poverty rates for foreign-born families are much higher than the U.S. average. The U.S. Commission on Civil Rights reports the poverty rates of foreign-born Chinese, Japanese, Korean, and Vietnamese families exceed those of U.S. average, which is 9.3 percent, whereas foreign-born Filipino and Indian Americans are less likely to be poorer than the U.S. average. Yet, it was just indicated that the average family income of Asians in America is higher than U.S. average. How is it that the poverty rate is higher, as well?

An explanation for this apparent paradox is that the poverty rate includes those Asian immigrants that have recently arrived in the States. Many of these immigrants take jobs that they are overqualified for to make ends meet. The poverty rate is especially high for the recent immigrants of Vietnam and Indochina, both lacking education and English skills. Over time, the poverty rate drops off. The unemployment rate for Vietnamese and Indochinese refugees, for example, was near 86 percent when they first arrived and after four years dropped considerably to 30 percent. [7]

Despite initial poverty, data from the 1980 Census shows that Asians are very little burden on state and federal public resources. With the exception of the Vietnamese refugees, a very small percentage of Asians will accept public assistance. See Table 3.

Table 3

U.S. AVERAGE AND ASIAN-AMERICAN RELIANCE ON PUBLIC ASSISTANCE AND SOCIAL SECURITY IN 1979
(Percent of households with)

Population	No Income From Own Earnings	Public Assistance	Social Security
U.S. Avg.	19.7	14.7	21.50
Japanese	9.5	4.2	18.5
Chinese	10.2	6.6	13.9
Filipino	7.0	6.6	13.9
Korean	8.1	6.2	5.7
Asian Indian	16.3	4.5	16.9
Vietnamese	20.1	28.1	5.2

SOURCE: Bureau of the Census, 1980 Census of Population, PC80-1-C1, General Social and Economic Characteristics, Tables 128, 138, and 164.

Aspiring to Homeownership

Among the 1.4 million Asian households in 1987, there were 638,000 homeowners, making the overall homeownership rate about 45 percent. This is lower than the U.S. average which was 63.5 percent.[8] In fact, compared to U.S. average, the homeownership rates for Asian homeowners are lower in every age group and for each income category. Partly, this is attributable to the fact that some Asians come from a country where 30 year mortgages do not exist. Some believe that if they do not have the cash, they cannot buy a house. However, immigrants appear to have an intense desire to own a piece of land, a house, or other real property. The number of foreign-born buyers is gradually increasing, and will continue to, as immigrants who came here five to 10 years ago become financially stable. Families who bought their homes a few years ago are now moving up the housing ladder.

The median home equity for Asian homeowners was about $70,000 in 1987, compared to $47,000 for all homeowners.[9] Interestingly, while they have greater equity in the homes, they also have greater debt, with a mortgage-to-total property value for Asian homeowners of 39.2 percent compared to 22.8 percent for U.S. average. The estimated median mortgage debt for Asian homeowners was $48,600 in 1985 -- almost three times as much as the $17,000 median for all homeowners.[10] Asians will save 20 to 50% for a down payment but still have a high mortgage debt.

The explanation lies in the fact that Asian immigrants tend to buy more expensive homes than the average first-time homebuyer. Most are living on the West Coast or in the East, where prices are high. In these particular regions, the average sales price of new one-family houses in 1987 was $146,000 in the Northeast, $133,000 in the West, but only $96,000 in the South and $75,500 in the Midwest.

There are no government homeownership programs that are specifically designed for Asian immigrants. However, there are some community outreach groups in cities where Asians dominate. These are usually headed by Asians already established in the community and assist newcomers who tend to feel more comfortable working with someone who speaks their native language. These groups sponsor seminars to explain the home-buying process. They are usually taught by foreign-born brokers in local churches or community centers, and attract clients through advertisements placed in Asian magazines and newspapers, local radio stations and in general, by word of mouth. These programs attempt to dispel the belief among Asian immigrants that if they do not have the cash they cannot buy. They are introduced to such concepts as down payment, credit laws and contract proceedings.

Conclusion

In the decades to come, virtually all Americans will feel the dual impact of Asian immigration and investment. Americans not directly touched by these trends will feel them indirectly. Asians are remaking our work-place and neighborhoods. As Asian immigrants become assimilated to the U.S. and American culture, they will become increasingly influential in everything from business and politics to law and academia, and of course, real estate. For Americans who can capitalize on ties between East and West, the Pacific boom will carry growing opportunity.

by
Lorraine Voss
Forecasting and Policy Analysis Division

1.Robert H. Gardner, Bryant Robey, and Peter C. Smith, Asian Americans: Growth, Change, and Diversity, Vol. 40, No. 4, Population Reference Bureau, 1985, p. 3.

2.Leon F. Bouvier and Robert W. Gardner, Immigration to the U.S. The Unfinished Story, Vol. 41, No. 4, Population Reference Bureau, 1986, p.13.

3.Gardner, Robey, and Smith, p.21.

4.The Economic Status of Americans of Asian Descent: An Exploratory Investigation, U.S. Commission on Civil Rights Clearinghouse Publication 95, October 1988, pgs. 47-50.

5.Ibid, pgs. 28-43.

6.Gardner, Robey, Smith, pgs. 34-36.

7.Ibid.

8.Tabulations of the American Housing Survey, 1987.

9.Ibid.

10.Ibid.

U.S. ECONOMIC OUTLOOK

JUNE 1990

	QUARTERS								YEARS				
	ACTUAL		FORECAST						ACTUAL		FORECAST		
	89.4	90.1	90.2	90.3	90.4	91.1	91.2	91.3	1988	1989	1990	1991	1992
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	5340	5431	5509	5583	5655	5737	5829	5921	4881	5234	5545	5877	6269
% Change	4.6	7.0	5.8	5.5	5.3	5.9	6.6	6.5	7.9	7.2	5.9	6.0	6.7
% Change (w/out inflation)	1.1	1.3	1.8	1.6	1.5	1.4	2.6	2.5	4.4	3.0	1.7	1.9	2.7
Consumer Price Inflation (CPI)	4.0	8.1	3.4	4.2	4.5	4.6	4.4	4.4	4.1	4.8	4.9	4.4	4.4
GNP Inflation (GNP Deflator)	3.2	5.7	4.0	3.8	3.8	4.4	3.8	3.9	3.3	4.2	4.2	4.0	3.9
Unemployment Rate - Civilian	5.3	5.3	5.5	5.6	5.8	5.8	5.9	5.8	5.5	5.3	5.5	5.8	5.6
Civilian Employment-Household Basis (millions)	117.8	118.1	118.4	118.5	118.4	118.6	118.9	119.3	115.0	117.3	118.3	119.1	120.7
Percent change	1.0	1.0	1.1	0.3	-0.2	0.7	0.9	1.2	2.3	2.0	0.9	0.7	1.4
Index of Industrial Production	108.1	108.4	108.9	109.2	109.6	110.0	110.9	111.9	105.4	108.1	109.0	111.5	115.9
Manufacturing Capacity Utilization	82.9	82.6	82.1	82.0	82.1	82.3	82.7	82.9	83.9	83.9	82.2	82.7	83.7
Domestic Auto Sales	6.2	7.0	6.5	6.7	6.8	6.8	7.0	7.0	7.5	7.1	6.8	7.0	7.1
Federal Tax Receipts (NIPA) as % of GNP	19.8	20.0	20.0	20.0	20.1	20.4	20.4	20.4	19.9	20.0	20.0	20.4	20.4
Federal Expenditures (NIPA) as % of GNP	22.7	23.1	22.7	22.6	22.5	22.6	22.5	22.3	22.9	22.8	22.7	22.4	21.8
Deficit(NIPA)	-156.0	-172.0	-153.0	-145.0	-136.0	-126.0	-120.0	-112.0	-145.0	-148.0	-151.0	-115.0	-85.0
as % of GNP	-2.9	-3.2	-2.8	-2.6	-2.4	-2.2	-2.1	-1.9	-3.0	-2.8	-2.7	-2.0	-1.4
REAL ESTATE MARKETS													
HOME SALES													
Total Single-Family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4495	4494	4347	4342	4363	4440	4474	4497	4646	4419	4387	4480	4442
Percent change – year ago	-7.8	0.5	1.0	-1.5	-2.9	-1.2	2.9	3.6	0.0	-4.9	-0.7	2.1	-0.8
Existing Single-family Home Sales (thousands)	3537	3440	3435	3420	3445	3475	3490	3505	3594	3440	3435	3496	3474
Percent change – year ago	-6.2	0.0	2.8	-0.7	-2.6	1.0	1.6	2.5	1.9	-4.3	-0.1	1.8	-0.6
Housing Starts (thousands)	1347	1459	1234	1252	1270	1346	1376	1399	1491	1386	1304	1384	1411
Percent change – year ago	-12.7	-3.1	-8.9	-6.3	-5.7	-7.7	11.5	11.7	-8.6	-7.0	-5.9	6.1	1.9
Single-Family Units	988	1087	940	950	946	995	1014	1023	1085	1009	981	1014	998
Percent change – year ago	-12.4	2.2	-5.2	-4.4	-4.2	-8.4	7.9	7.6	-5.9	-7.0	-2.8	3.4	-1.6
Multi-Family Units	359	371	293	301	323	351	362	375	405	376	322	369	412
2-4 Family Units	53	44	34	35	38	41	42	44	58	55	38	43	48
Percent change – year ago	-15.3	-25.4	-34.7	-36.1	-28.0	-5.5	23.2	24.3	-10.0	-5.7	-31.0	14.6	11.6
5 + Family Units	306	327	259	266	285	309	319	330	346	321	284	326	363
Percent change – year ago	-13.1	-14.5	-16.1	-7.0	-6.8	-5.5	23.2	24.3	-15.7	-7.3	-11.4	14.6	11.6
New Single-Family Home Sales (thousands)	652	591	576	590	610	615	625	640	676	650	592	633	640
Percent change – year ago	-4.1	-3.5	-9.4	-15.6	-6.4	4.0	8.5	8.5	0.4	-3.8	-8.9	6.9	1.2
Mobile Homes Shipped (thousands)	189	196	187	190	187	192	194	197	217	198	190	195	198
HOME PRICES													
Existing Home Prices - Median $(1000)	92.7	95.9	96.7	97.3	98.1	99.0	100.2	101.8	89.3	93.1	97.0	101.1	105.8
Percent change – year ago	6.2	4.5	4.0	2.5	5.9	3.2	3.6	4.6	4.3	4.3	4.2	4.2	4.6
New Home Prices - Median $(1000)	124.4	123.2	124.1	125.6	128.0	131.7	133.5	134.3	112.5	120.0	125.2	133.9	140.5
Percent change – year ago	9.8	5.8	3.8	5.0	2.9	6.9	7.6	6.9	7.7	6.7	4.4	6.9	5.0
FINANCIAL MARKETS													
Long-Term Interest Rates													
30-yr Fixed Rate Mortgage (FHA Secondary)	9.8	10.1	10.1	10.1	9.9	9.8	9.7	9.5	10.3	10.3	10.1	9.6	9.4
1-year ARM (effective rate)	8.8	8.6	8.4	8.3	8.3	8.4	8.5	8.5	8.5	9.3	8.4	8.5	8.5
Corporate AAA Bond Rate	8.9	9.2	9.2	9.2	9.0	8.9	8.8	8.6	9.7	9.3	9.1	8.7	8.5
Government Bond Rate	7.9	8.4	8.5	8.4	8.3	8.2	8.1	8.0	9.0	8.4	8.4	8.0	7.9
Short-Term Interest Rates													
Federal Funds Rate	8.6	8.3	8.1	7.9	7.8	7.7	7.6	7.6	7.6	9.2	8.0	7.6	7.5
3-month T-Bill Rate	7.7	7.8	7.6	7.5	7.3	7.1	7.0	6.9	6.7	8.1	7.6	7.0	6.8
Prime Rate	10.5	10.0	10.0	9.8	9.6	9.5	9.5	9.5	9.3	10.9	9.8	9.5	9.4
Discount Rate	7.0	7.0	7.0	7.0	6.7	6.5	6.5	6.5	6.2	6.9	6.9	6.5	6.2
Value of the U.S. Dollar (Trade-Weighted Avg.)	97.3	93.1	91.9	90.4	88.3	87.3	86.9	87.1	92.8	98.5	91.0	87.2	87.8
Percent change	-12.2	-16.0	-5.0	-6.5	-8.9	-4.7	-2.0	1.0	-4.3	6.2	-7.7	-4.2	0.7

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo and Robert Barr.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE OUTLOOK

Vol. 3, No. 7

July 1990

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The national economy enters the second half of the year with its seven-and-a-half year expansion at risk. Not since 1986 has the economy looked so prone to a recession: growth is low, housing starts are flagging, job growth is slowing, corporate profits are anemic, and fiscal and monetary policies appear restrictive. Yet several key indicators suggest that growth will continue, albeit slowly, and consequently the NAR forecast calls for less than moderate growth through 1992.
- Consumption spending, the largest component of GNP, has slowed significantly, and GNP has followed suit. It is estimated that consumption grew at an inflation-adjusted average annual rate of only 1.0 percent between October 1989 and June 1990. In the previous nine months, from January through September 1989, consumption spending had grown at a 3.2 percent pace.
- The forecast assumes that the Federal Reserve eases a bit in the second half of 1990, temporarily giving greater weight to avoiding a recession than to cutting inflation. The second quarter is expected to see consumer prices rise about 4.0 percent annually, halving the first quarter's 8.1 percent growth rate. Despite the sluggish economy, consumer prices are expected to grow near a 4 percent pace through the end of the forecast.
- Starts of privately-owned housing units dropped to an annual rate of 1.207 million units in May. This pace is 1.4 percent below April's annual rate of 1.224 million units and 7.7 percent below the May 1989 annual rate of 1.308 million units. Single-family starts fell to an annual rate of 896,000 units in May, suggesting that this series will have its weakest quarter since the recession year of 1982.
- Sales of new homes broke a string of five consecutive declines in May by increasing 0.4 percent to an annual rate of 532,000 units. The April figure, initially calculated at 546,000 units, was revised down to 530,000 units. New home sales are now 23 percent below the sales rate recorded during the its recent peak in November.

IN THIS ISSUE

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MASTERS OF THE HOUSE

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

Charge 'em for the dice; extra for the mice
Two percent for looking in the mirror twice
Here a little slice; there a little cut
Three percent for sleeping with the window shut

When it comes to fixin' prices,
There are lots of tricks he knows.
How it all increases, all those bits and pieces
It's amazing how it grows.

This little bit of nonsense from *Les Miserables* can be applied to several aspects of the economy and the financial sector. It might be posed as a hymn to all the high-livers and fast buck artists whose personal greed is now being visited on the American public in the form of the Savings and Loan bailout. Alternatively, it could be a selection from the training manual for those legions of bright, eager MBAs who turned the Wall Street of the Eighties into their personal gold mine until the crash forced them to grow up and see the world as it really is.

But now that the "T" word has escaped the President's mouth, and it's open season on tax schemes, what it really presents is a frightening view of a future dominated by the Puritans who feel that greed ought to be punished severely and that the last decade's excesses must be paid for with this decade's overtaxation. A national sales tax? Value-added taxes? See above for details.

With the costs of the savings and loan debacle, the persistent Federal budget deficit and the continuing involvement of the Congress in any and all issues, not even the most unimaginably large "peace dividend" can avert the legislation of new taxes. And as Oliver Wendell Holmes suggested, "To tax and be fair, like to love and be wise, is not given to man." The best we can hope for is that the basic notions of tax fairness find themselves into the law.

Ideally, taxes are used to fund the provision of goods--like national defense--that can't be supplied through the private market or for goods--like education and health care--whose consumption would be limited by the free market. They are best when they least distort economic incentives, when they are easiest to collect and when they inspire compliance. Thus, the income tax meets the criteria for a "good" tax, while inheritance taxes fail.

But taxes can also be used to change behavior, and that appears to be where we are now. The buzzword in Washington is "competitiveness": how can we catch the Japanese and keep up with the emerging superpower that is a united Europe? Here their tax factor enters the equation, because taxes that fall more heavily on income and less on wealth will encourage saving and investment. That investment will result in a more modern, more competitive economy.

Moreover, there are certain behaviors we want to discourage, like importing oil or consuming tobacco. Specific sales taxes will increase the cost of these goods and thus reduce their consumption. Yes, these taxes distort economic behavior, but that is their very purpose. The well-remembered horrors of the oil embargoes of the Seventies and the mounting evidence of deleterious health effects of alcohol and tobacco make the case for "sin taxes" very persuasive.

The arguments of economists may look elegant, but their chief virtue is that they allow the Congress' desire to raise revenue in the least politically damaging manner. A tax package consisting of a slight increase in the individual income tax (by popping the high income "bubble"), savings and investment incentives (a liberalization of capital gains and passive loss rules?) and increases in excise taxes meets the needs of the Congress, raises revenues to cut the deficit and can be defended by reference to the scribblings of all sorts of semi-reputable economists.

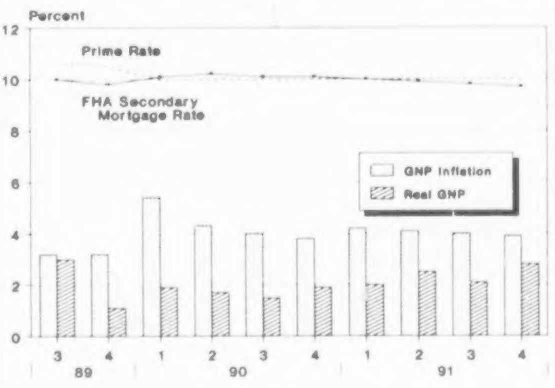
Can this economy stand a tax increase without recession? At this time, economic growth is weak and likely to remain so. The impact of a tax increase will be mitigated somewhat by the declining interest rates that will accompany a cut in the Federal deficit and a reduction of the government's demand for credit. On balance, there will be a marginal decline in economic growth, but not nearly enough to push us into recession. In fact, the cost increases levied on businesses by such a tax package would be less than those imposed by the new clean air law.

The danger here is that once the tax dialogue is opened seriously, all sorts of crackpot tax ideas can filter in. The prospect of a national sales tax or a value added tax is nothing short of frightening. Both have shown themselves in European economies to be inflationary and stagnating. We simply cannot afford to levy on ourselves a tax that stifles growth, pushes up prices and amounts to, in the words of John Lennon's taxman, "One for you, nineteen for me".

This is not an idle threat. The excesses of the savings and loan industry and the bad reputation of the go-go financial markets of the Eighties will produce a backlash, particularly among politicians whose best chances for election lie in appearing in the sackcloth and ashes of the tax reformer. So we could see serious discussion of moving to a tax regime that would devastate the prospects of the economy for steady growth through the Nineties. To do this in an effort to atone for the sins of the Eighties would be the height of foolishness. After all, greed may not be as good as Gordon Gekko would have us believe, but it's not a capital offense.

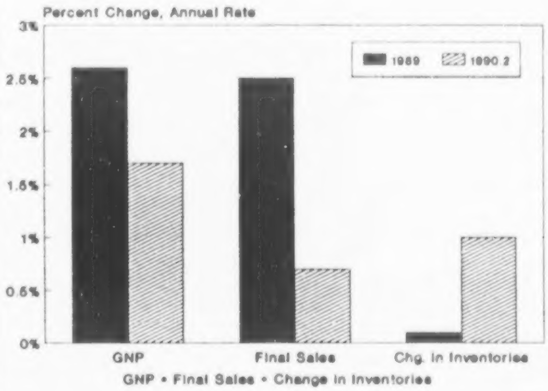
Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK



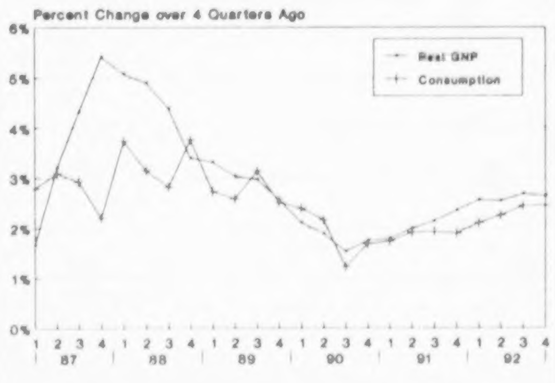
Source: Bureau of Economic Analysis; E NAR estimates.

FINAL SALES FALTER



Source: Department of Commerce

GNP GROWTH FOLLOWS THE CONSUMER



Source: Department of Commerce

The economy enters the second half of the year with its seven-and-a-half year expansion at risk. Not since 1986 has the economy looked so prone to a recession: growth is low, housing starts are flagging, job growth is slowing, corporate profits are anemic, and fiscal and monetary policies appear restrictive. Yet several key indicators suggest that growth will continue, albeit slowly, and consequently the NAR forecast calls for less than moderate growth through the remainder of 1990 and no recession through 1992. In the recently-completed second quarter of 1990, real GNP is projected to have grown at a 1.7 percent annual rate, just below the 1.9 percent pace of the first quarter.

Even the second quarter's low rate of growth may overstate the economy's current strength. Of the five major components of real GNP, growth in inventories appears to have accounted for well over half of the growth in the quarter. The remaining GNP components -- consumption, investment, net exports and government spending, and known collectively as final sales -- are expected to have been quite weak. The government's first reading on economic growth during the second quarter will be available later this month.

Final Sales Weak in the Second Quarter

The chart to the right shows the relative weakness of economic growth excluding inventory gains. In 1989, for example, the economy grew 2.6 percent. Virtually all of this growth came from final sales, which contributed 2.5 percentage points. Growth in inventories supplied the remaining 0.1 percentage point. In the second quarter of 1990, by contrast, the economy is projected to have grown 1.7 percent, with final sales contributing only 0.7 percentage point to growth while inventories added 1.0 percentage point. Of the final sales components, government spending and investment acted as a drag during the quarter, while consumer spending and net exports contributed some support.

This pattern of growth is troubling because, by its very nature, it is not sustainable. While some inventory building is healthy and expected, a high level of growth in inventories is incongruent with weak final sales, and production cutbacks may result. Yet industrial production has recorded strong gains in four of the past five months, including a 0.4 percent increase in June. Auto production has made important contributions, as automakers appear to be building inventories in advance of labor negotiations later this year. Of course, even without a strike, this may lead to less production later. Auto sales, meanwhile, have been stronger, running at a 7.3 million pace in early July and 8.1 million in late June.

Consumers Are Braking

Consumption spending, the largest component of GNP, has slowed significantly, and GNP has followed suit. It is estimated that consumption grew at an inflation-adjusted average annual rate of only 1.0 percent between October 1989 and June 1990. In the previous nine months, from January through September 1989, consumption spending grew at a 3.2 percent pace. One ominous sign of a recession -- three consecutive monthly declines in retail sales between March and May -- was countered by June's 0.5 percent gain. The forecast reflects the cautious mood by holding consumption growth to a 1.9 percent rate in both 1990 and 1991.

Of the components of GNP, consumer spending often provides an important cushion when other sectors of the economy, such as investment or net exports, lose steam. Without this safety margin, the expansion becomes increasingly fragile.

Job Creation Slows, But Labor Market Remains Firm

Since 1983, the private sector has created nonfarm jobs at an average pace of almost 225,000 jobs a month. This pace has slowed appreciably over the past year and a half. Manufacturing employment continues to be the hardest hit, losing another 30,000 jobs in June. Since March, 1989, factory payrolls are down by 335,000 workers. But overtime hours worked picked up in June, a signal that job losses may moderate. In addition, both the unemployment rate and the average workweek are signalling firmness, as the former dropped 0.1 percentage point to 5.2 percent and the latter edged up 0.1 hour.

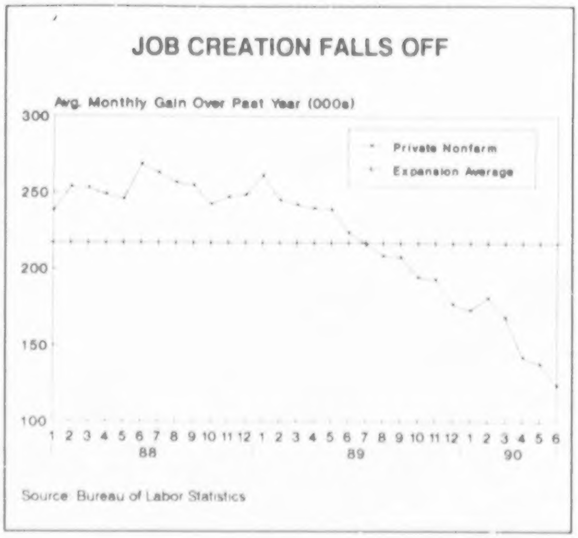
The Fed's Fight Against Inflation

In an effort to trim the inflation rate, the Federal Reserve has tightened monetary policy over the past couple of years. The chart at right shows the year-ago growth in nonborrowed reserves in the banking system. Slower reserve growth, all else being equal, limits the ability of financial institutions to make loans. Short-term interest rates generally rise to compensate for the lower volume of loanable funds, and, over time, growth in the economy slows. And in fact, reserve growth was slowed, short-term interest rates rose, and the economy decelerated. Inflation, however, has remained in the 4 - 5 percent range -- just where it was before the Fed began its tightening. The forecast assumes the Fed eases a bit in the second half of 1990, temporarily giving greater weight to avoiding a recession than cutting inflation.

The second quarter is expected to see consumer prices rise about 4.0 percent annually, halving the first quarter's 8.1 percent growth rate. Despite the sluggish economy, consumer prices are expected to grow near a 4 percent pace each quarter through the end of the forecast.

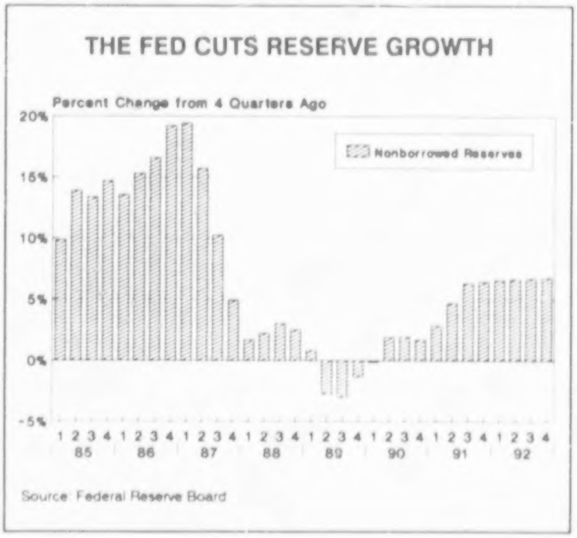
Good news regarding inflation can be found in the recent Producer Price Index (PPI) data. The chart at right shows the year-ago growth rate of the PPI's three major components. For the first time since 1988, the index for finished goods has fallen below the 4 percent year-ago growth rate. More significantly, the growth in the index for intermediate goods has slid from about 6 percent a year ago to almost zero percent today. As these intermediate goods work their way through the production process, the inflationary pressure on finished goods should ease.

The easing of inflation in the PPI is expected to be countered by continued higher costs for services, labor, and imported goods, all of which have only a minimal impact on the PPI. Additionally, as the economy recovers from its current lethargy, it is anticipated that PPI growth will return to the 4 to 5 percent band.



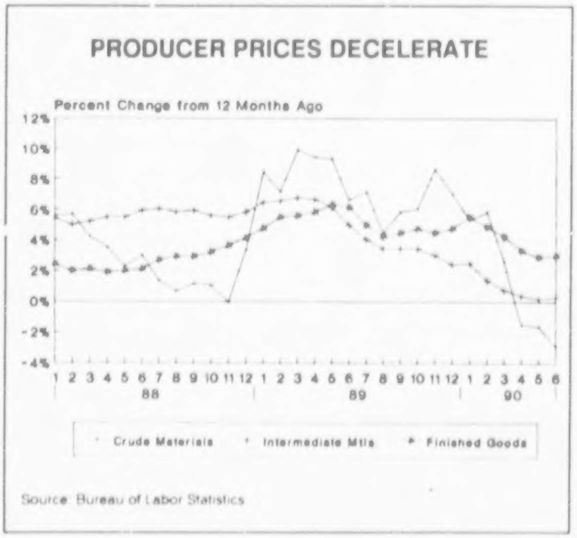
JOB CREATION FALLS OFF

Source: Bureau of Labor Statistics



THE FED CUTS RESERVE GROWTH

Source: Federal Reserve Board



PRODUCER PRICES DECELERATE

Source: Bureau of Labor Statistics

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

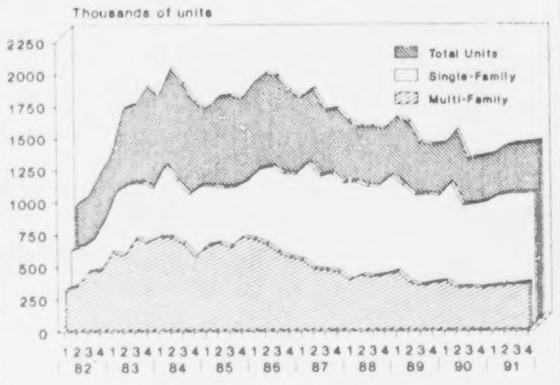
	Total	SF	2-4	5+
May 1989	1,308	977	42	289
Jan 1990	1,568	1,099	53	416
Feb 1990	1,488	1,154	42	292
Mar 1990	1,307	996	35	276
Apr 1990	1,224	905	54	265
May 1990	***1,207***	***896***	***36***	***275***
Annual Averages:				
1988	1,495	1,088	59	348
1989	1,389	1,012	56	322
Percent Changes in May 1990 since:				
May 1989	-7.7	-8.3	-14.3	-4.8
Apr 1990	-1.4	-1.0	-33.3	3.8

Regional Data

	Northeast	Midwest	South	West
May 1989	176	244	513	375
Jan 1990	168	373	526	504
Feb 1990	224	293	581	390
Mar 1990	139	280	520	368
Apr 1990	127	289	471	337
May 1990	***129***	***266***	***486***	***326***
Annual Averages:				
1988	243	274	574	405
1989	184	272	537	396
Percent Changes in May 1990 since:				
May 1989	-26.7	9.0	-5.3	-13.1
Apr 1990	1.6	-8.0	3.2	-3.3

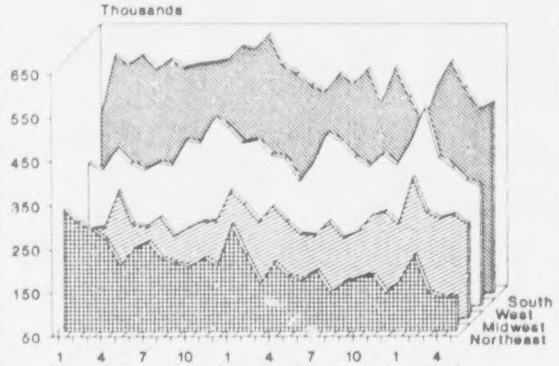
Source: Bureau of the Census; Construction Reports, Series C20

HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

HOUSING STARTS BY REGION



Source: Bureau of Census

Starts of privately-owned housing units dropped to an annual rate of 1.207 million units in May. This pace is 1.4 percent below April's annual rate of 1.224 million units and 7.7 percent below the May 1989 annual rate of 1.308 million units. Single-family starts fell to an annual rate of 896,000 in May, suggesting that single-family starts will have their weakest quarter since the final quarter of 1982, just before the U.S. economy began its current expansion. Multi-family units in May were started at a rate 6 percent lower than in May 1989. Construction in May 1990 in the 2 to 4 units category took place at a 36,000 unit annual pace, only 65 percent of rate recorded last year. Weakness in starts activity is expected to continue as builders are encountering scarce capital, due in large part to provisions of the the thrift bailout plan.

The downturn is concentrated in the Northeast, where housing was started at a 26.7 percent slower pace in May 1990 than in May 1989. This region has experienced a dropoff of 47,000 units in the past year, accounting for a little less than half of the entire U.S. decline in housing starts. The West region was down even more -- 49,000 units -- but the decline comes off a larger base, so that the percentage decline, 13.1 percent, is less than half the Northeast's. The South is also off its year-ago pace, but only by 5.3 percent. Only the Midwest has improved its rate of starts in the past year, upping starts 22,000 units to 266,000 in May 1990. Relative to their rates in April, the Northeast showed a mild upturn of 1.6 percent and the South expanded by 3.2 percent.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

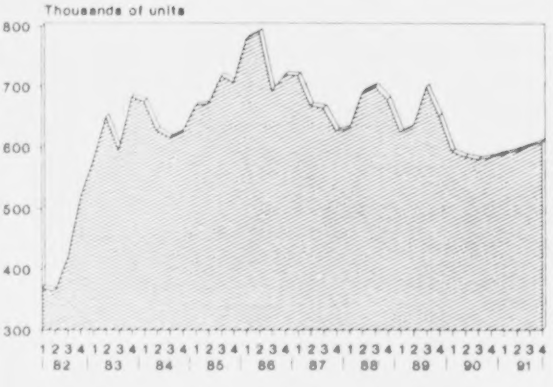
		Mo. Ago % Chg	Yr. Ago % Chg
May 1989	651	6.7	-4.1
Jun 1989	646	-0.8	-9.8
Jul 1989	741	14.7	5.7
Aug 1989	719	-3.0	1.0
Sep 1989	638	-11.3	-7.7
Oct 1989	636	-0.3	-11.4
Nov 1989	687	8.0	5.7
Dec 1989	633	-7.9	-5.4
Jan 1990	613	-3.2	-12.9
Feb 1990	606	-1.1	-2.7
Mar 1990	559	-7.8	0.5
Apr 1990	530	-5.2	-13.1
May 1990	***532***	***0.4***	***-18.3***
Annual Averages:			
1988	676		1.0
1989	654		-3.3

Regional Data

	Northeast	Midwest	South	West
May 1989	88	99	269	195
Nov 1989	96	117	263	211
Dec 1989	92	89	245	206
Jan 1990	94	104	226	189
Feb 1990	68	84	265	189
Mar 1990	86	94	221	157
Apr 1990	94	89	201	145
May 1990	***84***	***96***	***199***	***152***
Annual Averages:				
1988	101	97	276	202
1989	87	102	260	201
Percent Changes in May 1990 since:				
May 1989	-4.5	-3.0	-26.0	-22.1
Apr 1990	-10.6	7.9	-1.0	4.8

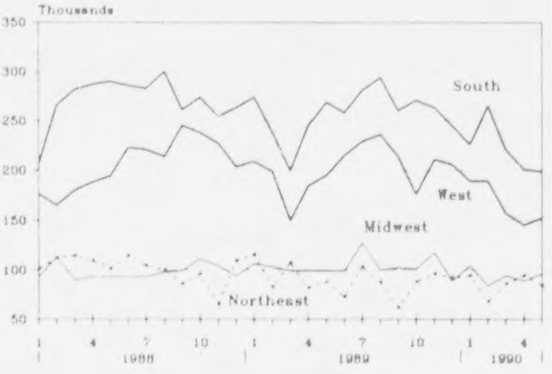
Source: Bureau of the Census; Construction Reports, Series C25

NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

NEW HOME SALES BY REGION



Source: Bureau of Census

Sales of new homes broke a string of five consecutive declines in May by increasing 0.4 percent to an annual rate of 532,000 units. The April figure, initially calculated at 546,000 units, was revised down to 530,000. The 1.6 percent decline in April follows a revised 8.4 percent decline in March. New home sales are now 23 percent below the sales rate recorded during its recent peak in November. Sluggish economic growth, tightening credit availability, and declining affordability have all hurt new homes sales over the past several months.

Although housing starts have had their greatest declines in the Northeast, the steepest drop-off in the sales of new homes over the past year has been in the South. New homes sold at a 199,000 annual rate in May, 26 percent below its year-ago level of 269,000 units. The West almost matched this with a 22.1 percent decline, falling to 152,000 units. The Northeast, meanwhile, dropped to 84,000 units, a decline of 4.5 percent. The Midwest recorded the smallest percentage decline with a 3 percent loss to 96,000 new homes.

May proved to be a good month for the Midwest and the West, each of which gained ground on April's sales rates. The Midwest was up 7.9 percent and the West was up 4.8 percent. The Northeast lost the momentum gained by April's 9.3 percent gain by falling back 10.6 percent. The new homes sales rate in the South fell for the third consecutive month to 199,000 units. Over this period, new home sales have been cut by 25 percent.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

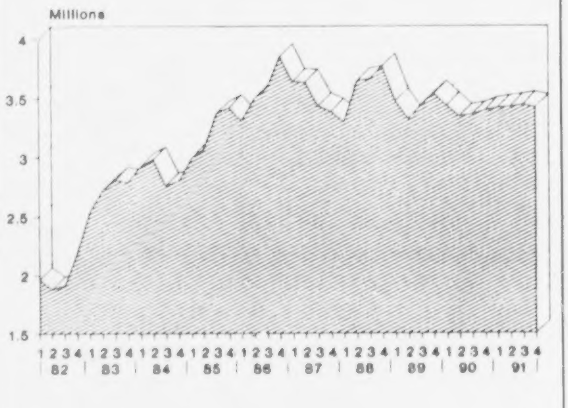
		Mo. Ago % Chg.	Yr. Ago % Chg.
May 1989	3,250	-5.5	-10.2
Jun 1989	3,330	2.5	-12.4
Jul 1989	3,380	1.5	-7.4
Aug 1989	3,440	1.8	-6.8
Sep 1989	3,510	2.0	-3.8
Oct 1989	3,490	-0.6	-5.2
Nov 1989	3,560	2.0	-4.0
Dec 1989	3,560	0.0	-9.2
Jan 1990	3,520	-1.1	-3.8
Feb 1990	3,400	-3.4	-4.2
Mar 1990	3,400	0.0	-0.9
Apr 1990	3,330	-2.1	-3.2
May 1990	***3,290***	***-1.2***	***1.2***
Annual Averages:			
1988	3,594		-1.9
1989	3,440		-4.3

Regional Data

	Northeast	Midwest	South	West
May 1989	600	840	1220	590
Dec 1989	580	980	1390	610
Jan 1990	560	940	1400	570
Feb 1990	560	890	1310	650
Mar 1990	500	910	1360	630
Apr 1990	520	920	1300	580
May 1990	***520***	***880***	***1310***	***590***
Annual Averages:				
1988	673	929	1350	642
1989	589	919	1307	610
Percent Changes in May 1990 since:				
May 1989	-13.3	4.8	7.4	0.0
Apr 1990	0.0	-4.3	0.8	1.7

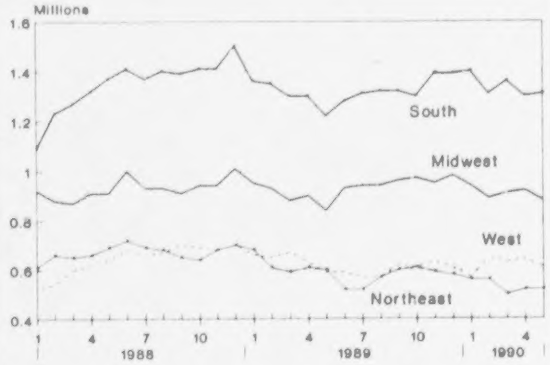
Source: Bureau of the Census; Construction Reports, Series C25

EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

May marks the sixth consecutive month that the annual rate of existing home sales failed to increase. The sales rate fell another 1.2 percent in May from April, leading to a 7.6 percent decline over the past six months. Nevertheless, the May sales figure was 1.2 percent above the sales rate recorded in May 1989. Year-to-date, new homes are selling at a 3,390,000 annual rate, about 1.5 percent below 1989's sales figure of 3,440,000.

The supply of existing homes on the market edged up 1.5 percent during the month to 2,700,000 homes. This represents a 5.9 percent increase over the May 1989 figure. At the current sales rate, the months' supply of existing homes stands at 9.9 months, up over the past twelve months from 9.4 months. This inventory-to-sales ratio is currently at its highest level in the past twelve months.

The Northeast was unable to build upon April's 4.0 percent increase in existing home sales during May. The sales rate held steady at 520,000 homes. Both the South and West posted gains relative to April, growing 0.8 percent and 1.7 percent, respectively. Only the Midwest experienced a decline, slipping 4.3 percent.

Relative to a year ago, the South's sales rate picked up 7.4 percent and stood at 1,310,000 units in May. The Midwest has also posted a solid gain over May 1989 with a 4.8 percent gain to 880,000-units annually. The West showed no change over its year-ago figure, but the Northeast fell by 13.3 percent, or 80,000 units.

SINGLE-FAMILY HOME PRICES

(In Dollars)

National Data

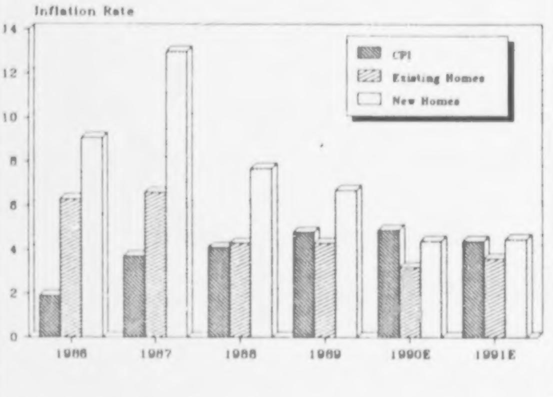
	Median		Average	
	Existing	New	Existing	New
May 1989	92,600	119,000	118,000	145,100
Jan 1990	96,300	125,200	120,000	151,700
Feb 1990	95,200	125,000	118,300	150,100
Mar 1990	96,300	119,400	119,500	144,100
Apr 1990	95,600	135,900	117,800	160,200
May 1990	***94,800***	***128,500***	***117,800***	***150,400***
Annual Averages:				
1988	89,300	112,500	112,800	138,300
1989	93,100	120,000	118,100	148,800
Percent Changes in May 1990 since:				
May 1989	2.4	8.0	-0.2	3.7
Apr 1990	-0.8	-5.4	0.0	-6.1

Regional Data

	Northeast	Midwest	South	West
May 1989	143,800	70,300	84,200	142,100
Jan 1990	147,100	75,600	85,300	144,400
Feb 1990	143,400	74,100	85,200	143,300
Mar 1990	148,800	75,500	86,000	141,800
Apr 1990	140,700	75,300	85,900	137,600
May 1990	***141,300***	***73,100***	***85,200***	***135,300***
Annual Averages:				
1988	143,000	68,400	82,200	124,900
1989	145,200	71,300	84,500	139,900
Percent Changes in May 1990 since:				
May 1989	-1.7	4.0	1.2	-4.8
Apr 1990	0.4	-2.9	-0.8	-1.7

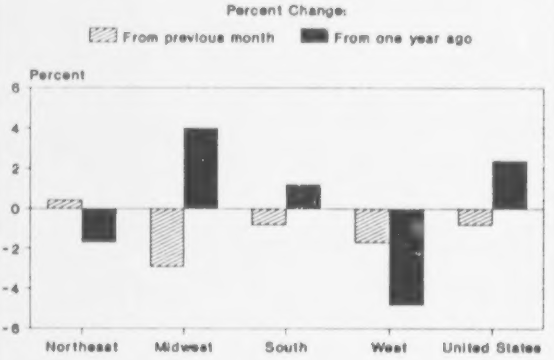
Source: NATIONAL ASSOCIATION OF REALTORS
Economics and Research Division

HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The median price for existing homes slipped for the third time in the past five months. The decline of 0.8 percent, or $800, in May left the price at $94,800. Relative to a year ago, the median price has risen $2,200, or 2.4 percent, from $92,900. The median price fell the furthest in the Midwest, where it dropped by 2.9 percent, or $2,200. The South and West each saw the median price fall, by 0.8 percent and 1.7 percent, respectively. In the Northeast, where the median-priced house is the costliest, the price rose by $600, or 0.4 percent. Relative to prices in May 1989, the costlier regions -- the Northeast and the West -- saw their median prices for existing homes rise, while the South and Midwest experienced price appreciation. The median price in the Midwest is now 52 percent of that in the Northeast, up from a 1989 average of 49 percent.

April's dramatic 13.8 percent increase in the median price of new homes was partially offset by May's 5.4 percent decline. The large increase during April indicated the thinness of the housing market for lower-priced new homes. The median price, $128,500, stands 8.0 percent above its year-ago level.

Robert D. Barr
Director of Forecasting
Forecasting & Policy Analysis Division

PROPOSALS TO CHANGE FHA AND THEIR IMPACTS

The Historical Housing Mission of FHA

The U.S. Department of Housing and Urban Development (HUD) is proposing changes to the insurance premium and up-front fees required to obtain Federal Housing Administration (FHA) insurance in its single-family (Sec. 203(b)) program, designed to preserve the insurance fund's fiscal soundness over the next decade. These changes could have adverse impacts on many middle- and moderate-income potential home buyers.

The Federal Housing Administration was created in 1934 in response to the lack of available mortgage insurance during the Great Depression. The goal of the FHA was to insure mortgage loans against default, which in turn would encourage lenders to make mortgage funds available to homebuyers. Since its creation, the FHA has helped over 17 million families purchase homes.

Today, FHA is still needed in order to continue providing assistance to potential homebuyers who would not be able to afford homes without FHA programs. NAR survey data and reports by other organizations demonstrate that the FHA program serves borrowers who have lower annual incomes, make smaller downpayments, and purchase lower value homes than homebuyers who utilize private mortgage insurance. Recent Harvard University Joint Center for Housing reports indicate that married families with children and households from 25-34 years of age, significant FHA consumer groups, were among the primary groups with declining homeownership rates. Without FHA, and unless the FHA mortgage insurance program is strengthened and expanded, many potential homebuyers will not be able to buy homes.

Importance of the FHA Program

In 1989, FHA insured-loans represented 23 percent of all homes sold (on a transaction basis). Over the last six years, FHA has accounted for more than 18 percent of all home sales transactions.

This measures the importance of FHA on a national basis; however, it is important to stress that the FHA program has a much greater importance to particular states and metropolitan areas. Tables 1 and 2 provide 1989 figures for FHA insured loans on new and existing homes and NAR figures for existing (attached and detached) homes sold.

FHA activity is precluded from many market areas by the existing maximum loan limits. Thus, since FHA is involved in one out of every five home sales on a national basis, it is clear that many local housing markets are crucially dependent upon FHA. Given FHA's current exposure in these markets, the HUD proposals would significantly weaken the financial viability of the FHA Mutual Mortgage Insurance Fund (MMIF) because of sharp increases in claims and losses in vulnerable housing markets.

The Price Waterhouse Study

The Washington, D.C. office of the accounting firm of Price Waterhouse, under contract to HUD, performed an analysis of the claim termination (default) experience of the FHA Mutual Mortgage Insurance Fund. A statistical equation was fit to cohorts of FHA loans originated from 1975 through 1987, to forecast future conditional claim rates. The selected time span covers a period where home prices were rapidly rising (late 1970s), then falling (early 1980s), and default rates were relatively low in the late 1970s early 1980s. However, defaults increased substantially due to mismanagement, fraud, and abuse in the mid- to late-1980s.

Because the historical time period chosen forms an inherent path of five to seven years of low defaults and seven later years of high defaults, the model tends to overpredict claims in the 1990s based purely on the 1980s experience. It is not likely that this experience will be duplicated in the 1990s.

Individual statistical equations were separately fit for six loan-to-value ratio (LTV) classes. Each statistical equation was constructed from 12 origination years with a sequence of annual claim rates. The basic dependent (predicted) variable was the ratio of the annual number of defaults in the period to the beginning of the year survivors for a group (cohort) of mortgages originated in a specified year (1975-1987). For a specified cohort, a series of up to 14 annual default rates is possible, representing the likelihood that a mortgage would enter default in a particular year given that it had not defaulted up to that point.

This model was used to simulate future defaults through the 1990s and projected an ultimate claim rate of about 12.5% (of FHA loans originated). By comparsion, the HUD Actuarial Division has forecast a long-term rate of at most 10%. For a variety of reasons, we believe that the PW model has overpredicted default rates for the 1990s and has thus chosen to make overly stringent recommendations. The consequence to the FHA program is that future FHA buyers will be required to pay much higher than necessary premiums and downpayments.

A Comparison of the Proposals

Table 3 presents a comparison of current FHA requirements, the HUD proposed changes, and the proposed Vento-Ridge amendment [introduced by U.S. Reps. Bruce Vento (D. - Minn.) and Thomas Ridge (R. - Pa.)] for a $65,000 home. Both the HUD and the Vento-Ridge proposals would restore the health of the Mutual Mortgage Insurance Fund (MMIF). Presented for the current FHA program, and the alternative proposals, are the following:

- Sales Price
- Financed Closing Costs
- Total Acquisition Cost
- Minimum Downpayment
- Mortgage Insurance Premium(MIP)
- Loan Amount before MIP
- Total Amount Financed
- FHA Loan-to-Value Ratio (LTV)
- True LTV
- Initial Cash Required
- Additional Closing Costs, and
- Total Up-front Cash Required of Borrowers at Settlement

Current Law

Under **current law**, a homebuyer who opts for FHA mortgage insurance would finance approximately $1,300 in allowable closing costs in the mortgage, resulting in a total acquisition cost of $66,300. The minimum downpayment required under current rules is $2,815, resulting in a loan amount before MIP of $63,485. The MIP is 3.8 percent of this amount, or $2,412 which is assumed to be financed in the loan. Total financed under current law would be $65,897. A true LTV on this transaction is 101.38 percent of the original sales price. As FHA calculates LTV (excludes the MIP premium from the calculation and uses the total acquisition cost as the base), this transaction has an LTV of 95.75 percent.

The amount of out-of-pocket cash required of the FHA borrower is the sum of minimum downpayment (initial cash required) plus those closing costs explicitly disallowed from financing (e.g., discount points, escrowed or pre-paid accounts, etc.). For this transaction, the up-front cash required is $4,115 -- $2,815 of which is the minimum downpayment and $1,300 is non-allowable closing costs. This is the baseline to which we compare the other options.

Administration/HUD Proposal

The **HUD proposal**, by comparison, would result in a higher up-front cash requirement of borrowers. The sales price is the same -- $65,000, but two-thirds of the formerly "allowable" closing costs must now be paid in cash at settlement. Of the $1,300 of closing costs which were formerly financed, only $433 can now be financed. For this proposal, the total acquisition cost is $65,433, and the minimum downpayment is $2,772. The loan amount before MIP is $62,661. The MIP is 3.8 percent of this amount or $2,381. The total amount financed is $65,042, resulting in a true LTV of 100.06 percent and an FHA LTV of 95.76 percent. Initial cash required is the sum of two components -- the $2,772 minimum downpayment plus the disallowed 2/3rds of closing costs of $867 -- or $3,639. After adding the additional closing costs which also cannot be financed ($1,300), the up-front cash requirement for borrowers under this proposal is $4,939 -- a 20 percent increase in out-of-pocket expense at closing as compared to current law.

Vento-Ridge Proposal

Under the **Vento-Ridge plan**, the FHA mortgage insurance premium would return to a pay-as-you-go system, such as the one it successfully operated under until 1982. Once the plan is phased in, borrowers would be required to pay closing costs and a 1.35 percent up-front premium, but both could be financed. An additional premium, as yet undetermined, would be assessed each year for the life of the loan.

The 1.35 percent up-front premium would be non-refundable and therefore would improve the Mutual Mortgage Insurance Fund (MMIF) financial reserves. Currently, a portion of the up-front premium is returned to borrowers who prepay their loans if there were no losses on the total amount of mortgages written in the year the loan was originated.

In the above examples, the up-front cash required at settlement would be the same as under the baseline, or $4115. This will hold true during and after the phase in to a 1.35 percent up-front premium in the sixth year. The sales price, allowable closing costs, total acquisition cost, minimum down payment and loan amount before the MIP is identical to the baseline during the phase-in period. The MIP required up-front declines from $2,381 in year one to $1,365 in year three and finally to $857 in year six. The total amount financed in years one, three, and six are $65,866, $64,850, and $64,342, respectively. The FHA LTV for all three years is the same as the baseline -- 95.75 percent. The true LTV declines from 101.33 percent in year one to 98.99 percent in year six.

Adverse Selection and Risk Based Premiums

An important conclusion from the Price Waterhouse analysis underlying the HUD proposal is the belief that risk based premiums will eliminate adverse selection to the FHA program. Price Waterhouse states that the current structure of the FHA mortgage insurance program creates a situation where the riskiest homebuyers select FHA over the conventional mortgage market. This occurs two ways: 1) those potential homebuyers who have little savings and cannot qualify for a loan in the conventional market select FHA; and 2) those homebuyers who do have savings select FHA and put down the bare minimum as required by FHA guidelines.

This second group, Price Waterhouse contends, when faced by the choice of higher premiums over time versus putting more down at settlement will opt to make a large downpayment to reduce their future outlays. The first group is the segment of current FHA homebuyers who Price Waterhouse has determined will "have to wait longer to purchase a home due to the increased cash needed at closing", i.e., this group will be denied FHA mortgage insurance. Requiring more from the already lower risk group and denying mortgage insurance to the highest risk group will change the level of risk entering the FHA "book of business" in future years. Unfortunately, the Price Waterhouse analysis did not include a market analysis of this premise, e.g., will the lower risk group pay more or will they opt to insure their home purchase through the conventional market?

Their assumption is that homebuyers will respond to the "real" cost (net present value) of buying a home, and not the "nominal" cost. Economic research of consumer response to increases in costs on durable goods indicate that consumers are much more responsive to changes in nominal prices, and not real prices. The lower risk homebuyer who is currently selecting the FHA mortgage insurance program will respond to the increased cash requirements under the HUD proposal by making a price comparison between FHA and private mortgage insurance and will select to leave the FHA program. They will not, as assumed by Price Waterhouse, simply pay significantly more at closing to avoid a slight increase in mortgage payments over time.

A substantive weakness of the Price Waterhouse study is that the loss of low-risk homebuyers from the FHA Mutual Mortgage Insurance program was not modeled. The HUD proposals will effectively weaken the MMIF by eliminating the current level of cross subsidization by the low-risk homebuyers, and will result in introducing more, not less, risk into all future FHA "books of business".

Estimated Number of Households Excluded from FHA due to HUD Proposal

There are two effects which will prevent potential homebuyers from using the FHA mortgage insurance program under the HUD proposal. The increase in closing costs combined with the risk based premium structure will displace approximately 93,000 homebuyers. The estimates for each are provided below:

Increase in Closing Costs. The HUD proposal would disallow two-thirds of currently allowable closing costs from the FHA mortgage loan. For the average 1989 FHA loan (approximately $70,000), the HUD proposal would raise the out-of-pocket transaction costs by approximately $935. A rule of thumb is that approximately 60,000 households would not qualify for a home for every one percent increase in closing costs. Thus, 80,150 estimated households would be displaced.

Risk Based Premium. The HUD proposal also includes a risk based surcharge based on the initial FHA Loan-to-Value (LTV). The surcharge is a .5 percent annual premium collected monthly with the mortgage payment. The duration of the surcharge varies depending upon the initial LTV, and ranges from 4 years to 15 years for the highest LTV class. FHA homebuyers who make a 10 percent or greater downpayment are not charged. A rule of thumb is that approximately 300,000 households would not qualify for a home for every one percent increase in the monthly mortgage interest rate. The HUD proposal would raise the average monthly contract rate by .042%. The estimated number of households who would be displaced by the increase in monthly mortgage payment is 12,600.

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Table 1

Existing Home Sales And FHA Mortgages Endorsed

(Calender Year 1989, by State)

	FHA ENDORSEMENTS						Existing Home Sales	S-F Housing Starts
	New Construction		Existing Construction		Totals			
State	Units	Mortgage Amount (000s)	Units	Mortgage Amount (000s)	Units	Mortgage Amount (000s)		
Alabama	1,300	$83,154	6,744	$357,269	8,044	$440,423	51,100	11,512
Alaska	52	6,517	2,820	228,258	2,872	234,775	7,100	1,260
Arizona	3,257	268,503	17,694	1,129,751	20,951	1,398,254	63,400	20,844
Arkansas	923	50,978	7,444	346,658	8,367	397,636	47,500	7,462
California	15,075	1,370,075	49,125	4,025,795	64,200	5,395,870	538,800	161,877
Colorado	807	68,777	25,957	1,633,119	26,764	1,701,896	43,800	9,509
Connecticut	221	20,286	2,978	281,701	3,199	301,987	51,400	8,550
Delaware	95	6,721	867	62,341	962	69,062	12,800	4,914
District of Columbia	11	850	1,158	86,258	1,169	87,108	9,000	96
Florida	9,160	617,604	29,416	1,743,949	38,576	2,361,553	185,900	106,737
Georgia	1,232	88,671	18,920	1,284,708	20,152	1,373,379	82,000	41,579
Hawaii	881	95,917	1,900	204,395	2,781	300,312	12,100	6,391
Idaho	643	41,873	5,244	259,580	5,887	301,453	13,500	4,799
Illinois	741	62,495	25,409	1,662,711	26,150	1,725,206	187,900	6,398
Indiana	1,233	91,407	15,072	744,854	16,305	836,261	87,700	32,386
Iowa	55	3,591	5,560	243,314	5,615	246,905	52,900	21,083
Kansas	324	22,911	7,021	365,346	7,345	388,257	45,100	8,325
Kentucky	371	21,839	6,297	313,271	6,668	335,110	70,700	13,810
Louisiana	659	45,161	9,034	492,328	9,693	537,489	35,400	6,694
Maine	32	2,605	1,131	81,527	1,163	84,132	30,400	5,697
Maryland	3,921	336,250	19,306	1,517,194	23,227	1,853,444	82,000	31,961
Massachusetts	4	289	1,013	93,698	1,017	93,987	86,500	15,437
Michigan	163	9,485	16,407	733,831	16,570	743,316	178,600	32,147
Minnesota	3,650	304,362	21,747	1,433,348	25,397	1,737,710	72,800	19,909
Mississippi	576	36,421	4,982	251,471	5,558	287,892	31,500	7,360
Missouri	859	59,441	13,789	756,686	14,648	816,127	83,800	17,438
Montana	185	11,687	3,719	186,473	3,904	198,160	12,700	945
Nebraska	515	33,969	5,299	246,290	5,814	280,259	24,000	4,221
Nevada	3,493	274,895	5,308	364,375	8,801	639,270	12,900	16,733
New Hampshire	5	455	345	30,299	350	30,754	12,700	5,701
New Jersey	113	8,745	5,337	402,276	5,450	411,021	128,000	23,467
New Mexico	704	49,133	3,517	216,030	4,221	265,163	19,100	5,067
New York	478	37,238	16,055	980,101	16,533	1,017,339	198,300	30,434
North Carolina	2,013	143,365	15,311	953,209	17,324	1,096,574	132,800	50,236
North Dakota	113	7,509	2,661	126,479	2,774	133,988	11,700	1,157
Ohio	1,416	99,043	26,375	1,321,352	27,791	1,420,395	189,100	30,928
Oklahoma	750	50,335	10,122	478,918	10,872	529,253	53,600	5,961
Oregon	459	32,057	6,560	356,024	7,019	388,081	59,700	11,441
Pennsylvania	155	10,549	15,893	880,085	16,048	890,634	242,900	38,109
Rhode Island	7	608	1,720	165,397	1,727	166,005	12,900	2,839
South Carolina	551	38,252	6,121	336,194	6,672	374,446	60,200	16,200
South Dakota	155	10,727	1,982	91,686	2,137	102,413	14,400	1,458
Tennessee	1,209	78,270	18,082	1,060,507	19,291	1,138,777	105,400	24,010
Texas	5,714	439,084	52,747	3,006,805	58,461	3,445,889	229,300	36,864
Utah	1,421	97,092	8,190	442,005	9,611	539,097	14,400	6,019
Vermont	1	85	146	11,078	147	11,163	11,900	3,215
Virginia	2,949	216,374	20,445	1,478,191	23,394	1,694,565	100,300	43,318
Washington	1,141	90,526	17,542	1,162,626	18,683	1,253,152	61,100	25,722
West Virginia	25	1,383	1,681	81,265	1,706	82,648	45,900	1,966
Wisconsin	56	4,001	4,148	205,933	4,204	209,934	70,300	16,341
Wyoming	54	3,834	3,001	148,115	3,055	151,949	6,000	691
U.S. Totals	**69,927**	**$5,455,399**	**569,342**	**$35,065,074**	**639,269**	**$40,520,473**	**3,993,300**	**1,007,218**

Note: Total Existing Home Sales includes single family apartment condos and co-ops.

Sources: Federal Housing Administration, A43(SFIS) Database, Office of Management, Housing Information & Statistics Division, March 4, 1990; NAR Economics & Research Division.

Table 2

FHA Endorsements Relative to Home Sales and Housing Starts

(Calender Year 1989, by State)

State	New Construction Units	S-F Housing Starts	State Share (%)	Existing Construction Units	Existing Home Sales	State Share (%)
Alabama	1,300	11,512	11.29	6,744	51,100	13.20
Alaska	52	1,260	4.13	2,820	7,100	39.72
Arizona	3,257	20,844	15.63	17,694	63,400	27.91
Arkansas	923	7,462	12.37	7,444	47,500	15.67
California	15,075	161,877	9.31	49,125	538,800	9.12
Colorado	807	9,509	8.49	25,957	43,800	59.26
Connecticut	221	8,550	2.58	2,978	51,400	5.79
Delaware	95	4,914	1.93	867	12,800	6.77
District of Columbia	11	96	11.46	1,158	9,000	12.87
Florida	9,160	106,737	8.58	29,416	185,900	15.82
Georgia	1,232	41,579	2.96	18,920	82,000	23.07
Hawaii	881	6,391	13.79	1,900	12,100	15.70
Idaho	643	4,799	13.40	5,244	13,500	38.84
Illinois	741	6,398	11.58	25,409	187,900	13.52
Indiana	1,233	32,386	3.81	15,072	87,700	17.19
Iowa	55	21,083	0.26	5,560	52,900	10.51
Kansas	324	8,325	3.89	7,021	45,100	15.57
Kentucky	371	13,810	2.69	6,297	70,700	8.91
Louisiana	659	6,694	9.84	9,034	35,400	25.52
Maine	32	5,697	0.56	1,131	30,400	3.72
Maryland	3,921	31,961	12.27	19,306	82,000	23.54
Massachusetts	4	15,437	0.03	1,013	86,500	1.17
Michigan	163	32,147	0.51	16,407	178,600	9.19
Minnesota	3,650	19,909	18.33	21,747	72,800	29.87
Mississippi	576	7,360	7.83	4,982	31,500	15.82
Missouri	859	17,438	4.93	13,789	83,800	16.45
Montana	185	945	19.58	3,719	12,700	29.28
Nebraska	515	4,221	12.20	5,299	24,000	22.08
Nevada	3,493	16,733	20.87	5,308	12,900	41.15
New Hampshire	5	5,701	0.09	345	12,700	2.72
New Jersey	113	23,467	0.48	5,337	128,000	4.17
New Mexico	704	5,067	13.89	3,517	19,100	18.41
New York	478	30,434	1.57	16,055	198,300	8.10
North Carolina	2,013	50,236	4.01	15,311	132,800	11.53
North Dakota	113	1,157	9.77	2,661	11,700	22.74
Ohio	1,416	30,928	4.58	26,375	189,100	13.95
Oklahoma	750	5,961	12.58	10,122	53,600	18.88
Oregon	459	11,441	4.01	6,560	59,700	10.99
Pennsylvania	155	38,109	0.41	15,893	242,900	6.54
Rhode Island	7	2,839	0.25	1,720	12,900	13.33
South Carolina	551	16,200	3.40	6,121	60,200	10.17
South Dakota	155	1,458	10.63	1,982	14,400	13.76
Tennessee	1,209	24,010	5.04	18,082	105,400	17.16
Texas	5,714	36,864	15.50	52,747	229,300	23.00
Utah	1,421	6,019	23.61	8,190	14,400	56.88
Vermont	1	3,215	0.03	146	11,900	1.23
Virginia	2,949	43,318	6.81	20,445	100,300	20.38
Washington	1,141	25,722	4.44	17,542	61,100	28.71
West Virginia	25	1,966	1.27	1,681	45,900	3.66
Wisconsin	56	16,341	0.34	4,148	70,300	5.90
Wyoming	54	691	7.81	3,001	6,000	50.02
U.S. Totals	**69,927**	**1,007,218**	**6.94**	**569,342**	**3,993,300**	**14.26**

Note: Total Existing Home Sales includes single family apartment condos and co-ops.

Sources: Federal Housing Administration, A43(SFIS) Database, Office of Management, Housing Information & Statistics Division, March 4, 1990; NAR Economics & Research Division.

Table 3
Loan Financing Analysis of Various FHA Options

Variable	Current Law	HUD Proposal	Vento/Ridge 1st Year	Vento/Ridge 3rd Year	Vento/Ridge 5th Year
A. Selling Price	65,000	65,000	65,000	65,000	65,000
B. Financable Closing Costs (1)	1,300	433	1,300	1,300	1,300
C. Acquisition Costs	66,300	65,433	66,300	66,300	66,300
D. Down Payment	2,815	2,772	2,815	2,815	2,815
(Non-financable closing Costs)	0	867	0	0	0
E. Loan Amount Before MIP	63,485	62,661	63,485	63,485	63,485
F. MIP	2,412	2,381	2,381	1,365	857
G. Total Financed	65,897	65,042	65,866	64,850	64,342
H. FHA LTV (%) (3)	95.75	95.76	95.75	95.75	95.75
I. True LTV (4)	101.38	100.6	101.33	99.77	98.99
J. Initial Cash Required	2,815	3,639	2,815	2,815	2,815
K. Additional Closing Costs (2) (Loan Orgination & Escrow)	1,300	1,300	1,300	1,300	1,300
L. Up-front Cash Required of Borrower	4,115	4,939	4,115	4,115	4,115

(1) HUD allows up to 3% of selling price; assumes 2% based on historical data.

(2) One discount point for loan and one point for prepaid escrow (currently cannot be financed). (Total closing costs of 4%)

(3) Loan amount before MIP amount divided by Aquisition Cost (Line E divided by Line C).

(4) Total Financed divided by Selling Price (Line G divided by Line A).

Notes: PMI case represents typical PMI pricing of 95%. LTV mortgage assumes 1.25% premium at settlement.

U.S. Economic Outlook: July 1990

	89.4	90.1	90.2	90.3	90.4	91.1	91.2	91.3	1988	1989	1990	1991	1992
U.S. Economy													
Average Annual Growth Rate													
Real GNP	1.1	1.9	1.7	1.5	1.9	2.0	2.5	2.1	4.4	3.0	1.8	2.1	2.6
Industrial Production	0.2	0.7	4.1	0.8	1.8	1.7	2.8	2.5	5.4	2.6	1.2	2.1	3.2
Civilian Employment	1.0	1.0	0.8	0.9	0.1	0.9	1.1	1.1	2.3	2.0	0.9	0.8	1.4
GNP Inflation Index	3.2	5.4	4.3	4.0	3.8	4.2	4.1	4.0	3.3	4.2	4.2	4.1	4.0
Consumer Prices	4.0	8.1	3.6	4.0	4.4	4.5	4.7	4.6	4.1	4.8	4.9	4.4	4.5
Value of the U.S. Dollar	-12.2	-16.0	-2.9	-5.0	-9.8	-5.7	-2.6	0.9	-4.3	6.2	-7.2	-4.4	0.6
Percent													
Mfg. Capacity Utilization	82.9	82.6	83.0	82.3	82.4	82.4	82.6	82.8	83.9	83.9	82.6	82.7	83.4
Civilian Unemployment	5.3	5.3	5.3	5.4	5.6	5.6	5.7	5.7	5.5	5.3	5.4	5.7	5.6
Percent of GNP													
Federal Tax Receipts	19.8	20.0	20.0	20.1	20.4	20.6	20.6	20.6	19.9	20.0	20.1	20.6	20.6
Federal Expenditures	22.7	23.1	22.7	22.5	22.4	22.5	22.4	22.2	22.9	22.9	22.7	22.3	21.7
Federal Budget Deficit	-2.9	-3.1	-2.7	-2.5	-2.0	-2.0	-1.8	-1.7	-3.0	-2.8	-2.6	-1.7	-1.1
Interest Rates, Percent													
Federal Funds Rate	8.6	8.3	8.3	8.2	8.3	8.3	8.3	8.2	7.6	9.2	8.2	8.3	8.1
3-Month T-Bill Rate	7.7	7.8	7.8	7.7	7.7	7.6	7.6	7.5	6.7	8.1	7.7	7.5	7.1
Prime Rate	10.5	10.0	10.0	10.0	10.0	10.0	10.0	10.0	9.3	10.9	10.0	10.0	9.8
Discount Rate	7.0	7.0	7.0	7.0	7.1	7.2	7.3	7.3	6.2	6.9	7.0	7.3	7.0
Corporate AAA Bond Yield	8.9	9.2	9.4	9.2	9.2	9.1	9.0	8.9	9.7	9.3	9.2	9.0	8.7
30-Year Government Bond Yield	7.9	8.4	8.6	8.5	8.5	8.4	8.4	8.3	9.0	8.4	8.5	8.3	8.1
Mortgage Rates, Percent													
30-Year Fixed Rate	9.8	10.1	10.2	10.1	10.1	10.0	9.9	9.8	10.3	10.3	10.1	9.9	9.6
1-Year Adjustable	8.8	8.6	8.5	8.4	8.4	8.4	8.5	8.5	8.5	9.3	8.5	8.5	8.4
Home Sales													
Thousands													
Total Single-Family (Single-family resales plus 97% of single-family starts)	4,495	4,491	4,224	4,253	4,309	4,375	4,400	4,418	4,646	4,419	4,319	4,397	4,416
Existing Single-Family	3,537	3,440	3,344	3,361	3,397	3,417	3,427	3,444	3,594	3,440	3,386	3,427	3,444
New Single-Family	652	593	585	581	584	590	595	602	676	650	586	599	610
Housing Starts	1,347	1,454	1,226	1,243	1,260	1,322	1,345	1,352	1,491	1,386	1,295	1,346	1,392
Single-Family Units	988	1,083	907	919	940	987	1,002	1,003	1,085	1,009	962	1,000	1,002
Multi-Family Units	359	371	319	324	319	334	342	348	405	376	333	346	390
2-4 Family Units	53	43	37	37	37	39	40	40	58	55	38	40	45
5+ Family Units	359	371	319	324	319	334	342	348	405	376	333	346	390
Mobile Homes Shipped	189	196	196	191	186	192	194	194	217	198	192	194	197
Percent change -- Year Ago													
Total Single-Family	-7.8	0.0	-3.8	-3.5	-4.1	-2.6	4.2	3.9	0.0	-4.9	-2.3	1.8	0.4
Existing Single-Family	-6.2	-1.1	-2.5	-2.4	-4.0	-0.7	2.5	2.5	1.9	-4.3	-1.6	1.2	0.5
New Single-Family	-4.0	-5.1	-8.3	-16.9	-10.5	-0.6	1.7	3.6	0.4	-3.8	-9.9	2.2	1.9
Housing Starts	-12.7	-3.4	-9.5	-7.1	-6.5	-9.1	9.7	8.8	1.3	-12.7	-6.5	8.6	2.8
Single-Family Units	-12.4	1.8	-8.6	-7.6	-4.8	-8.8	10.6	9.2	4.6	-12.4	-4.8	7.3	-0.9
Multi-Family Units	-13.5	-15.9	-12.0	-5.4	-11.1	-10.0	7.5	7.6	-6.6	-13.5	-11.1	12.3	13.2
2-4 Family Units	-15.3	-26.6	-30.2	-32.5	-30.0	-10.0	7.5	7.6	13.2	-15.3	-30.0	12.3	13.2
5+ Family Units	-13.1	-14.3	-8.8	-0.1	-7.8	-10.0	7.5	7.6	-9.4	-13.1	-7.8	12.3	13.2
Median Home Prices													
Thousands of Dollars													
Existing Home Prices	92.7	95.9	94.7	96.4	97.1	98.4	98.6	99.8	89.3	93.1	96.0	99.5	103.3
New Home Prices	124.4	123.2	124.7	125.9	127.4	129.0	130.9	132.4	112.5	120.0	125.3	131.5	137.7
Percent Change - Year Ago													
Existing Home Prices	6.2	5.2	2.0	1.6	4.8	2.6	4.1	3.6	4.3	4.3	3.2	3.6	3.8
New Home Prices	9.8	5.3	2.1	5.3	2.4	4.7	4.9	5.1	7.7	6.7	4.4	4.5	4.6

Source: Forecast produced using Laurence H. Meyer & Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo and Robert Barr.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The stage has been set for the end of the U.S. economy's long expansion. The Mideast crisis and anemic growth in the recent past indicate that a recession is imminent. The NAR forecast now includes a brief downturn, beginning in the final quarter of 1990 and ending in the first quarter of 1991. Growth in U.S. output in 1990 is expected to be only 1.1 percent, and the growth rate for 1991 is projected to be only 0.5 percent. The economy is expected to rebound nicely in 1992, expanding at a 3.1 percent rate.
- The annual GNP three-year revisions gave the forecast a new, and sharply bleaker, point of departure. Real GNP growth over the four quarters of 1989 averaged only 1.8 percent, according to the revised figures, not the 2.6 percent as had been previously reported. The revisions suggest that a recession was probably in the cards before the Mideast crisis broke.
- Sustained double-digit inflation growth, last seen after the 1979 oil shock, is not expected as a result of the current crisis, thanks in part to less dependence on oil in the U.S. economy.
- The weak economy is showing up in the housing markets, where the number of new units started fell for the ninth time in the past twelve months. The annual rate for June was 1,177,000 units, the lowest level since the end of the last recession in October 1982 and 16.8 percent below the June 1989 figure. For the second quarter, housing starts averaged 1,199,000 units, a steep 17.5 percent decline from the first quarter's rate of 1,454,000 units.
- The number of new homes sold rose for the second consecutive month in June but remains 10 percent below the rate set a year earlier. During the second quarter, new homes were sold at a 548,000 annual rate, 7.4 percent below the first quarter's rate. For the next few quarters, the increase in uncertainty about the direction of the economy is expected to dampen new home sale activity. The annual figure for 1991 is projected to be 535,000 units, almost 20 percent below the 1989 figure. Although 1992 will be a year of recovery, the annual rate will also stand below the 1989 figure.

IN THIS ISSUE

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Saddam Who? Sane?

by
John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

Let's get the ugly rumors off the table right from the start. Bill Seidman did not precipitate the current Mideast crisis to raise the market value of RTC holdings in the Oil Patch. But it would be worthy of a Robert Ludlum novel if that were the real cause, wouldn't it? And that may make more sense than to believe that a national leader of a third-rate country would choose to take the *entire* world just to get the price of oil up by a third. But he has, and as a result this country is probably headed into recession by the end of this year.

In reality, recession is not rooted in Hussein's mad gamble. Rather, the oil crisis merely makes its coming more certain. In reality, the economic slowdown has developed because consumers took a hike. This expansion has been consumer driven, and so it's fitting that it is braking on a fall in consumer confidence. Between the first quarter of 1989 and the first quarter of 1990, the Index of Consumer Confidence maintained by the University of Michigan fell by nearly 20 percent. And with that fall has come a stagnation in real consumer expenditure. Since consumer spending constitutes nearly 70 percent of GNP, that change is crucial.

Why? In an economy that is still creeping forward, where interest rates and inflation (at least before the Gulf crisis) appeared under control, how can consumers be so gloomy? Well, to begin with, they look out and see their hard-earned dollars about to be siphoned off to pay for the thrift rescue and pull in their spending horns to guard against a bleaker tomorrow. And they turn to their mail to find charge account bills and loan payments and find out that it's time to pay the piper after the great spending binge of the Eighties.

Moreover, the economy is slowing down. People are smart enough to project a trend and ask themselves: The expansion has lasted eight years; will the slowdown be as long? Finally, there is the incessant drumbeat of the financial press, trying to find yet another story of economic fragility and blast this at the public. Top it all off with the insanity in the Middle East and--as Roseanne Rosanadanna would say--it's always something.

Not that this is the proverbial ill wind; there will be some winners from an oil shock recession. Clearly, oil production and the drilling products industry will get a shot in the arm even if the price goes no higher than $28 a barrel. Alternative energy fuel production will also be enhanced. The net of all these further boosts an Oil Patch economy that was already coming back. This is in fact good news for the Resolution Trust Corporation, which will see its costs cut by rising real estate values in Texas, Oklahoma and Louisiana.

The real bad news comes for those industries most sensitive to fuel prices. The recently announced hikes in airfares are the first public example, but more will come in trucking and other parts of the transportation sector. As we found out in 1973 and 1979, petroleum dominates most of this economy, so look for the effects of Mr. Hussein's aggression to show up in chemical and plastic-intensive industries.

Homebuilding gets hit two ways. On the supply side, housing uses a great deal of oil-related products, so the cost of bringing construction to the market will rise. At the same time, households will find themselves with less spendable income and will be less inclined to think of buying homes. As construction slows, building suppliers will feel the pinch, and so on and so on. That's how we get a recession.

But let's put this in perspective. We are not facing--shooting war or no--another shock like either of those of the Seventies. This time around, everyone is on our side; and even if the world caves in completely, Hussein is still demanding only a limited rise in oil prices. Yes, we will feel the pinch, but only as an intensification of the trend that was begun a year ago by nervous consumers.

The details of our current forecast can be found within. Basically, we are now predicting a mild two quarter recession at the end of 1990 and the beginning of 1991. But the recession will bring down interest rates and allow the Fed to ease up on monetary policy, allowing recovery to kick in next spring and open up full bore by the end of the year. By that time, both homebuilding and home sales will have returned to the rates we saw at the end of 1989.

The eight years of expansion that we have enjoyed are coming to a pause, not an end. We've tiptoed along a recessionary ridge for the past six months and the gentleman from Baghdad is about to nudge us over the edge. By historical standards, this will be a short, mild recession, and the economy ought to be back on its growth creep by mid-1991. In short, even though daddy's taken the T-bird away, we may yet have some fun, fun, fun.

Outlook for the Economy and Real Estate

The stage has been set for the end of the U.S. economy's long expansion. The Mideast crisis and anemic growth in the recent past indicate that a recession is imminent. The NAR forecast now includes a brief downturn, beginning in the final quarter of 1990 and ending in the first quarter of 1991. Growth in U.S. output in 1990 is now expected to be only 1.1 percent, down from the 1.8 percent rate in last month's forecast. But more significantly, the growth rate for 1991 has been severely cut, from 2.1 percent in last month's outlook to only 0.5 percent in the current forecast. The economy is expected to rebound nicely in 1992, expanding at a 3.1 percent rate.

Whether the economic turbulence ahead is officially designated a recession or not is of little importance. What is important is that the economy is stringing together several quarters of extremely slow growth which will feel like a recession to many regions, industries, companies, and individuals. The housing market, for example, is one of these industries.

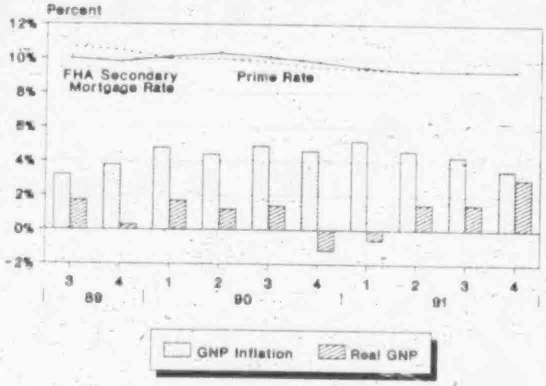
A New Point of Departure

As far as the outlook for the U.S. economy is concerned, the most significant development since the last forecast did not occur on August 3 as Iraqi tanks crossed into Kuwait. While the threat of another oil shortage tipping an already-weak U.S. economy into a recession makes for a more dramatic story and certainly has its consequences for the outlook, the events of July 27 have played a more important role in shaping the outlook for the next several quarters. On that day, in its routine annual benchmark revision of the U.S. economy's production record, the government released a new picture of where the economy had been in the preceeding three-and-a-half years.

The revision gave the forecast a new, and sharply bleaker, point of departure. Real GNP growth over the four quarters of 1989 averaged only 1.8 percent, according to the revised figures, not the 2.6 percent as had been previously reported. The household saving rate in the first quarter of 1990 was revised down to 4.9 percent from 5.8 percent, implying that consumers may not have the cash on hand to increase consumption spending. Income growth was weaker than had been expected, and the preliminary estimate of second-quarter growth stood at 1.2 percent growth. Final demand -- all of the components of GNP except inventory building -- fell at 1.5 percent clip during the quarter.

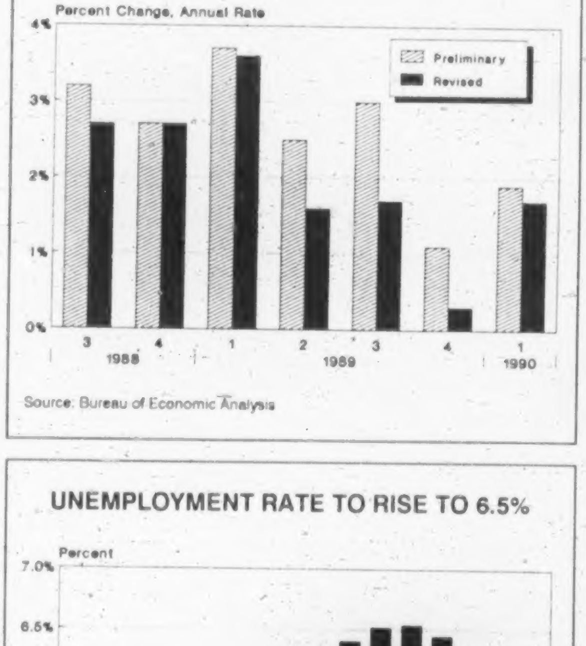
Given the new figures, a recession was probably in the cards before the Mideast crisis broke. Other indicators pointed in the same direction. The unemployment rate jumped 0.3 percentage points to 5.5 percent in July, the highest rate since August 1988. Second-quarter results for corporate profits were weaker than had been expected, continuing the softness in that category. Retail sales were weak in July, up only 0.1 percent (before adjusting for inflation). Housing starts fell again in July to an annual rate of 1,148,000 units, almost 20 percent below the rate set in July 1989.

THE ECONOMIC OUTLOOK



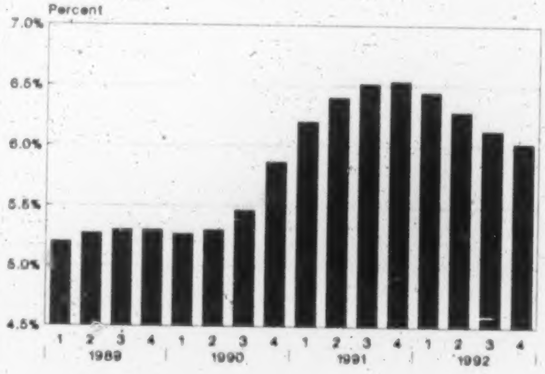
Source: Bureau of Economic Analysis; NAR forecast

REVISIONS SHOW LESS GNP GROWTH



Source: Bureau of Economic Analysis

UNEMPLOYMENT RATE TO RISE TO 6.5%



Source: Bureau of Labor Statistics; NAR forecast

A High Hurdle for the Expansion

The expansion has shown remarkable resilience in its seven-and-a-half years, and there are reasons to think that growth may continue uninterupted through 1991, although at a slow pace. Nevertheless, the economic fundamentals are quite weak today. For example, the stock market crash of October 1987 came at a time when output averaged 3.9 percent growth and employment growth averaged 2.6 percent over the preceeding four quarters. Today, real GNP growth over the past four quarters stands at only 1.2 percent, and employment growth is only 0.9 percent.

Mideast Crisis Increases the Burden

Now add to this the economic forces unleashed by the Mideast crisis. Oil prices, of course, have risen dramatically. The cost of an imported barrel of oil stood close to $16 in July; the year-end cost is now expected to average $25 -- a jump of over 50%. The NAR forecast assumes oil prices will peak at $29 a barrel in the third quarter and settle down to $25 by the end of 1992.

Other impacts are reflected in the forecast. For example, progress on cutting the federal budget deficit has stalled, and the negotiators have fewer options. Cuts in defense spending are not going to be as deep, and the likelihood of raising gasoline taxes has fallen sharply. Consumer confidence, meanwhile, is dropping, as are hopes of a consumer-led return to moderate economic growth.

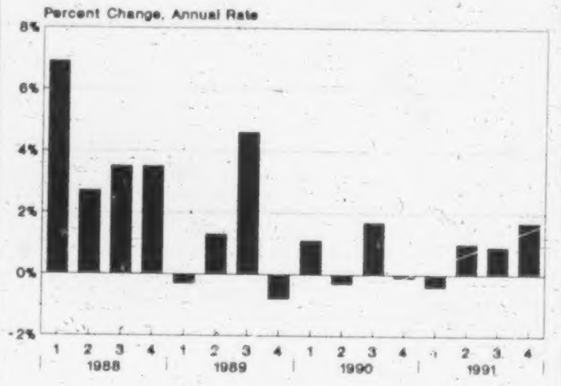
Inflation to Remain in Single-Digits

Sustained double-digit inflation growth, last seen after the 1979 oil shock, is not expected as a result of the current crisis, thanks in part to a U.S. economy that is now less dependent on oil. For example, in 1988, the U.S. required 20 percent less oil than it did in 1979 to produce $1,000 of output. And the economy is not hampered with the oil price controls of 1973-74, which restrained the market from responding with greater supplies. Although the coming months will undoubtedly bring some unpleasant inflation reports, the increase in oil prices finds a different inflationary climate today than it did in 1973, when loose monetary policy and a strong economy kept upward pressure on prices.

But the crisis puts the Federal Reserve in a difficult spot. Moves to ease credit to dampen the recessionary blow could boomerang later as fuel for higher inflation. Less wage pressure in the labor markets, due in part to the slower economy, will mitigate the impact of higher oil prices on inflation. The Fed is expected to ease in response to the underlying weakness in the economy, but not so much so as to shield the economy from the blows of higher oil prices. Easing to that extent would set the Fed back in its fight against inflation and damage one of its most precious commodities -- its credibility in the financial markets.

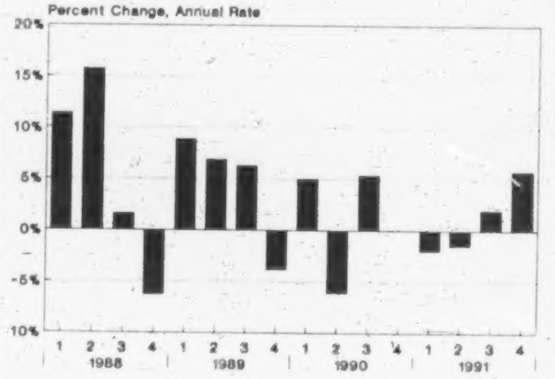
Although inflation is rising, it won't spiral out of control, giving the Fed some room to fight the weak economy with easier monetary policy. Uncertainty over the Persian Gulf will keep rates up in the near term, but yields are expected to fall over the next year.

CONSUMER SPENDING HAS SLOWED. . .



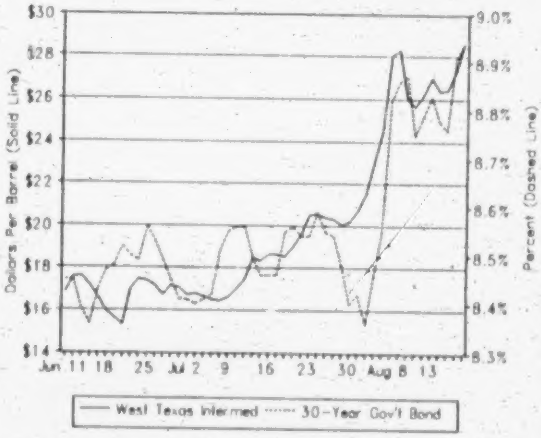
Source: Bureau of Economic Analysis; NAR forecast

. . . AS HAS BUSINESS INVESTMENT



Source: Bureau of Economic Analysis; NAR forecast

BOND YIELDS FOLLOW OIL PRICES



HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

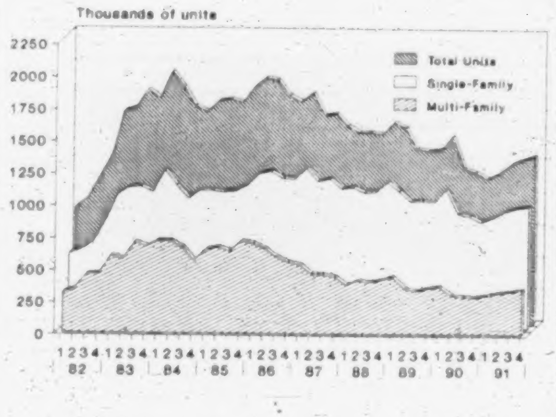
	Total	SF	2-4	5+
Jun 1989	1.414	971	55	388
Feb 1990	1,488	1,154	42	292
Mar 1990	1,307	996	35	276
Apr 1990	1,216	898	53	265
May 1990	1,205	893	39	273
Jun 1990	***1,177***	***892***	***41***	***244***
Annual Averages:				
1988	1,488	1,081	59	348
1989	1,376	1,003	55	318
Percent Changes in June 1990 since:				
Jun 1989	-16.8	-8.1	-25.5	-37.1
May 1990	-2.3	-0.1	5.1	-10.6

Regional Data

	Northeast	Midwest	South	West
Jun 1989	168	242	553	451
Feb 1990	224	293	561	390
Mar 1990	139	280	520	368
Apr 1990	124	284	469	339
May 1990	128	261	489	327
Jun 1990	***114***	***237***	***532***	***294***
Annual Averages:				
1988	243	274	574	405
1989	184	272	537	396
Percent Changes in June 1990 since:				
Jun 1989	-32.1	-2.1	-3.8	-34.8
May 1990	-10.9	-9.2	8.8	-10.1

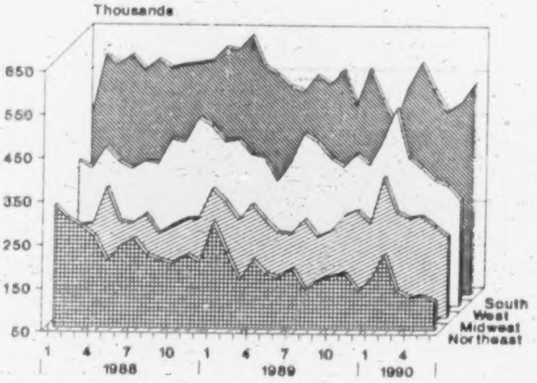
Source: Bureau of the Census; Construction Reports Series C20

HOUSING STARTS



Source: Bureau of Census; Real Estate Outlook forecast

HOUSING STARTS BY REGION



Source: Bureau of Census

The weak economy is showing up in the housing markets, where the number of new units started fell for the ninth time in the past twelve months. The annual rate for June was 1,177,000 units, the lowest level since the end of the last recession in October 1982 and 16.8 percent below the June 1989 figure. For the second quarter, housing starts averaged 1,199,000 units, a steep 17.5 percent decline from the first quarter's rate of 1,454,000 units.

Housing starts are projected to reach bottom in the fourth quarter of 1990 at a 1,124,000 annual rate. Lower interest rates, largely a result of the slumping economy, should modestly boost housing starts in 1991 to 1,247,000 units, and economic recovery in 1992 is expected to spur housing starts to 1,337,000 units.

Multi-family units continue to bear the brunt of the decline in housing starts. In June, multi-family units were started at a 285,000-unit annual rate, 36 percent below the rate in June 1989. The current NAR forecast calls for multi-families to reach its nadir in the fourth quarter of 1990 with a 291,000-unit rate. This would place multi-families below the low point reached during the last recession, when in the first quarter of 1982 only 311,000 multi-family units were started. The pace of construction is projected to pick up to 329,000 units in 1991 and 367,000 units in 1992.

During June, all four regions remained below their rates for housing starts of one year ago. The biggest declines were recorded by the Northeast and the West. Only the South posted a gain in June relative to May.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

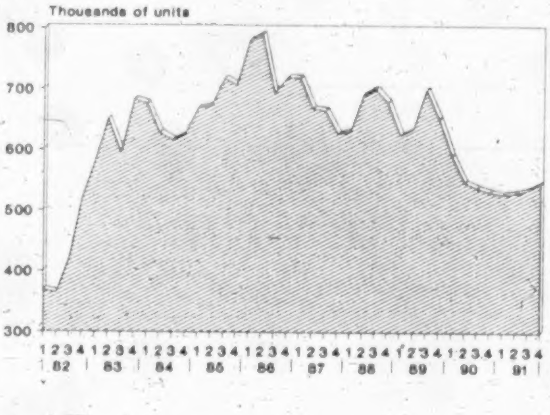
		Mo. Ago % Chg	Yr. Ago % Chg.
Jun 1989	646	-0.8	-9.8
Jul 1989	741	14.7	5.7
Aug 1989	719	-3.0	1.0
Sep 1989	638	-11.3	-7.7
Oct 1989	636	-0.3	-11.4
Nov 1989	687	8.0	5.7
Dec 1989	633	-7.9	-5.4
Jan 1990	613	-3.2	-12.9
Feb 1990	606	-1.1	-2.7
Mar 1990	558	-7.9	0.4
Apr 1990	526	-5.7	-13.8
May 1990	538	2.3	-17.4
Jun 1990	***581***	***8.0***	***-10.1***
Annual Averages:			
1988	676		0.8
1989	654		-3.3

Regional Data

	Northeast	Midwest	South	West
Jun 1989	73	99	258	215
Dec 1989	92	89	245	206
Jan 1990	94	104	226	189
Feb 1990	68	84	265	189
Mar 1990	84	94	221	159
Apr 1990	89	89	202	146
May 1990	75	94	214	155
Jun 1990	***102***	***90***	***243***	***146***
Annual Averages:				
1988	101	98	271	206
1989	90	103	258	202
Percent Changes in June 1990 since:				
Jun 1989	39.7	-9.1	-5.8	-32.1
May 1990	36.0	-4.3	13.6	-5.8

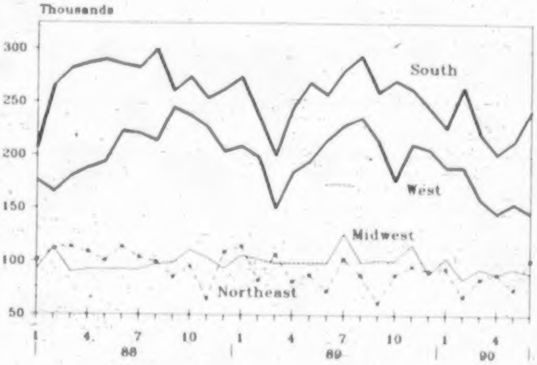
Source: Bureau of the Census; Construction Reports, Series C25

NEW HOME SALES



Source: Bureau of Census; Real Estate Outlook forecast

NEW HOME SALES BY REGION



Source: Bureau of Census

The number of new homes sold rose for the second consecutive month in June but remains 10 percent below the rate set a year earlier. During the second quarter, new homes were sold at a 548,000 annual rate, 7.4 percent below the first quarter's rate.

For the next few quarters, the increase in uncertainty about the direction of the economy is expected to dampen new home sale activity. The pace is expected to drop to 528,000 units during the first quarter of 1991 before recovering to 547,000 by the end of the year. The annual figure for 1991 is projected to be 535,000 units, almost 20 percent below the 1989 figure. Although 1992 will be a year of recovery, the annual rate will also stand below the 1989 figure, but by 14 percent.

The Northeast rang up a big increase in new homes sold in June, growing almost 40 percent from its May figure. New homes were sold in the region at an annual rate of 102,000 units. Nevertheless, the region's annual rate for the first half of the year still trails the 1989 rate, 85,000 units to 90,000 units.

The South also had strong growth in June relative to May, posting a 13.6 percent increase. Both the Midwest and the West experienced declines relative to June. Like the Northeast, the other three regions are running below their 1989 averages through the first half of the year. The West is the worst off, with new homes sold during the first half of 1990 almost 20 percent below 1989's pace. The South and the Midwest have each fallen about 10 percent.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

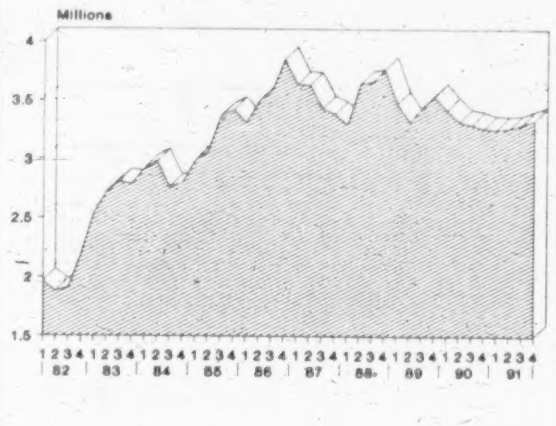
		Mo. Ago % Chg	Yr. Ago % Chg
Jun 1989	3,330	2.5	-12.4
Jul 1989	3,380	1.5	-7.4
Aug 1989	3,440	1.8	-6.8
Sep 1989	3,510	2.0	-3.8
Oct 1989	3,490	-0.6	-5.2
Nov 1989	3,560	2.0	-4.0
Dec 1989	3,560	0.0	-9.2
Jan 1990	3,470	-2.5	-5.2
Feb 1990	3,400	-2.0	-4.2
Mar 1990	3,400	0.0	-0.9
Apr 1990	3,330	-2.1	-3.2
May 1990	3,300	-0.9	1.5
Jun 1990	***3,340***	***1.2***	***0.3***
Annual Averages:			
1988	3,594		-1.9
1989	3,467		-3.6

Regional Data

	Northeast	Midwest	South	West
Jun 1989	520	930	1280	590
Jan 1990	560	940	1400	570
Feb 1990	560	890	1310	650
Mar 1990	500	910	1360	630
Apr 1990	520	920	1300	580
May 1990	520	880	1320	570
Jun 1990	***490***	***960***	***1310***	***580***
Annual Averages:				
1988	669	929	1348	643
1989	590	931	1320	617
Percent Changes in June 1990 since:				
Jun 1989	-5.8	3.2	2.3	-1.7
May 1990	-5.8	9.1	-0.8	1.8

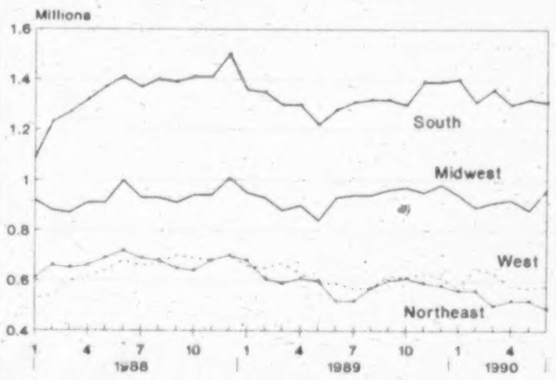
Source: Bureau of the Census; Construction Reports, Series C25

EXISTING HOME SALES



Source: NAR Economics & Research; Real Estate Outlook forecast

EXISTING HOME SALES BY REGION



Source: NAR Economics & Research

June saw only the second increase in the past nine months for existing home sales, which ran at a 3,340,000 annual rate during the month. This placed sales 0.3 percent ahead of last June's figure of 3,330,000. During the second quarter, sales dipped 100,000 units, or about 3 percent, from the first quarter's 3,423,000 rate.

Existing home sales are expected to drop for the next three quarters, hitting bottom at 3,268,000 units during the first quarter of 1991. Jitters about the health of the U.S. economy will lead homebuyers to remain cautious throughout the remainder of the year. As the economy recovers from the mild recession projected to end in early 1991 , existing home sales are expected to make a slow recovery. Besides the higher incomes and confidence engendered by the stronger economy, lower interest rates are also expected to boost home-buying activitiy. In 1991, existing home sales are expected to number 3,295,000 units, and in 1992 that figure is projected to grow by almost 4 percent to 3,408,000 units.

Only the South has outpaced its 1989 sales rate in the first half of 1990, despite a lower sales rate in June than in May. The region's rate is 1 percent higher, to 1,330,000 units. The Midwest is about 2 percent off its 1989 sales rate through the first six months of 1990, while West is off by a little more than 3 percent. The Northeast has taken the biggest blow so far this year, dropping off 11 percent with a sales rate of 52,500 units.

SINGLE-FAMILY HOME PRICES

(In Dollars)

National Data

	Median		Average	
	Existing	New	Existing	New
Jun 1989	93,500	122,800	119,000	153,600
Jan 1990	96,300	125,000	120,000	151,700
Feb 1990	95,200	125,200	118,300	150,900
Mar 1990	96,300	119,400	119,500	144,600
Apr 1990	95,600	131,000	117,800	153,900
May 1990	95,600	127,900	118,700	149,700
Jun 1990	***97,500***	***129,000***	***120,500***	***152,900***
Annual Averages:				
1988	89,200	113,400	112,500	138,900
1989	92,900	120,400	118,000	148,300
Percent Changes in June 1990 since:				
Jun 1989	4.3	5.0	1.3	-0.5
May 1990	2.0	0.9	1.5	2.1

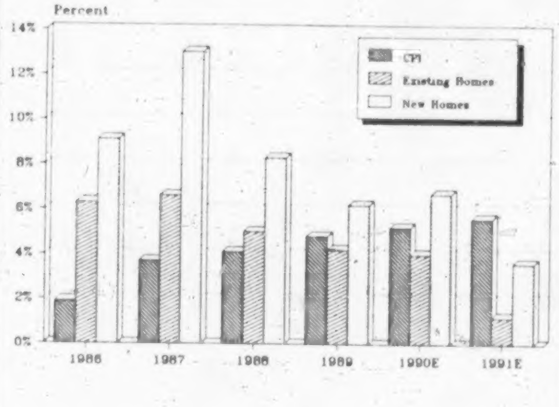
Regional Data

Median Prices for Existing Single-Family Homes

	Northeast	Midwest	South	West
Jun 1989	149,700	72,000	85,100	135,000
Jan 1990	147,100	75,600	85,300	144,400
Feb 1990	143,400	74,100	85,200	143,300
Mar 1990	148,800	73,500	86,000	141,800
Apr 1990	140,700	75,300	85,900	137,600
May 1990	141,300	73,500	85,100	141,800
Jun 1990	***148,500***	***76,200***	***87,500***	***135,400***
Annual Averages:				
1988	142,500	68,200	82,200	124,700
1989	145,100	71,200	84,400	139,800
Percent Changes in June 1990 since:				
Jun 1989	-0.8	5.8	2.8	0.3
May 1990	5.1	3.7	2.8	-4.5

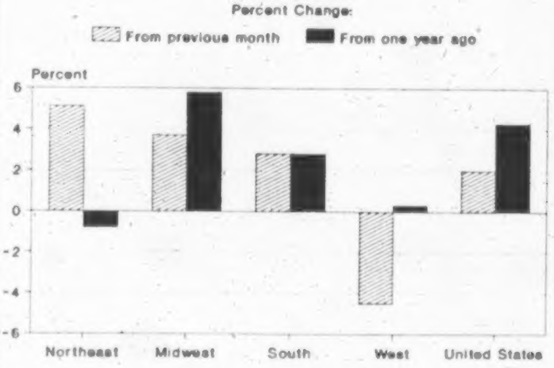
Source: National Association of Realtors
Economics and Research Division

HOME PRICES



Source: Bureau of Census; E Real Estate Outlook forecast

HOME PRICES BY REGION



Source: NAR Economics & Research; Real Estate Outlook forecast

The median price of existing single-family homes rose 2 percent in June to $97,500. The $4,000 increase represents a 4.3 percent rise over the same month a year ago. The median price for new homes grew by $1,100 during the month of June to $129,000 and now stands 5 percent above its year-ago figure. Both increases come during a time of weakness in the housing markets, when prices on individual homes are less likely to be rising. This suggests that the composition of homes being sold is changing -- the ratio of high-priced homes to low-priced homes is rising, forcing the median price up.

The average price for existing homes is rising less slowly than the median price, meanwhile. The average price rose 1.3 percent to $120,500 in the twelve months since June 1989. The average price for new homes has fallen one half of one percent in this time, to $135,400.

The median price on existing homes recorded its biggest regional gain over the past year in the Midwest. The price rose $4,200 to $76,200. The median price rose 2.8 percent in the South and 0.3 percent in the West. A -0.8 percent decline was recorded in the Northeast ahas recorded the biggest gain in the past year for the median price on existing homes.

The forecast calls for the median price on existing homes to be $96,700 in 1990 and $97,800 in 1991.

Robert D. Barr
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RECREATIONAL PROPERTIES AND SECOND HOMES: CURRENT USE AND FUTURE DEMAND

The NATIONAL ASSOCIATION OF REALTORS®, American Resort and Residential Development Association's Political Education Fund, and the International Foundation for Timesharing have just released an important study measuring the extent and characteristics of recreational property and second home ownership. The study, The American Recreational Property Survey: 1990, was undertaken by Ragatz Associates, a Eugene, Oregon consulting firm specializing in recreational property research.

Methodology

The questionnaires used in the study were developed jointly by the sponsoring organizations and the research organization. In total, four questionnaires were used: one administered to households who are recreational property owners, the other three to households which do not presently own recreational property. Multiple questionnaires were used in order to hold down the number of questions which would be asked of any one household. They were administered over the telephone by professionally trained and experienced telephone research interviewers (Mar%Stat, Inc., Eugene, Oregon), between March 2 and April 2, 1990. Calls were based on a random digit telephone list developed by a firm specializing in survey samples. The list had been purged of all known business numbers beforehand, but included numbers which would be unlisted in telephone directories. All 50 states and the District of Columbia were included in the sample. In total, some 5,636 interviews were completed.

Number of Households Owning Recreational Property

Some 7.6 percent of households resident in the United States own recreational property of some type. Using the Census Bureau's best existing estimate for 1990 (the Series B projection, for July 1, 1990, of 94.2 million households), this would indicate there are 7.2 million households owning recreational property.

An important subset of recreational property owners for purposes of comparison with prior studies are those who own second homes; that is, properties offering some type of accommodations (as opposed to raw land or camp sites). Presently, some 5.5 million households own such property, or about 5.8 percent of all U.S. households.

The number of households owning recreational property of all types has increased by about 2.4 million or 50 percent since 1973. This represents an average annual net increase of about 141,000 households. But the proportion of all households owning recreational property has changed little since 1973: from seven percent to the current 7.6 percent. Most of the growth is simply due to an increase in the number of households in the U.S. while ownership rates have increased slowly.

The number of households owning second homes--an important subset of recreational property ownership--has tripled since 1967, from 1.7 million to 5.5 million. However, the proportion of all households owning second homes has only doubled, from 2.9 percent to 5.8 percent. Again, we see that much of the growth is due to an increase in household numbers, not an increase in market penetration.

Ownership by Region

Study results show the highest rate of ownership to be in the West. Although only 23.5 percent of all recreational property owners live there, due to the relatively low population density this represents 8.7 percent of households who reside in the West. The North Central region has the lowest rate of ownership at 7.0 percent, because although 22.4 percent of recreational property owners reside there it has a relatively large overall population.

The difference between an 8.7 percent and 7.0 percent rate of ownership is not great. This lack of strong regional variation was also true of the 1973 Opinion Research Corporation study (see

Reference). That study found ownership rates varying by only about one percent from region to region.

Ownership by Marital Status

Recreational property ownership rates vary much more significantly with household characteristics. For example, while married couples are only about 56 percent of households, they represent over 78 percent of recreational property owners. Married couples are nearly 90 percent more likely to own recreational property than other households. This finding is in keeping with the 1967 Census Bureau study, which found that 82 percent of second home owners were married couples.

Ownership by Housing Tenure, Age, and Income

Ownership rates also vary significantly with housing tenure. Home owners represent nearly nine out of ten recreational property owners, but only 63.8 percent of all households. Thus, home owners are over four times as likely to own recreational property as renters. These figures are in keeping with the 1967 Census Bureau findings (see References), in which 82 percent of second home owners were primary home owners. They also closely match the 1973 Opinion Research Corporation findings, which showed that nine percent of home owners, but only five percent of renters, owned some type recreational property.

The vast majority of recreational property owners (70.2 percent) are between 35 and 64 years of age; a time of life when incomes are high and living situations relatively stable. For this reason, households in the 45 to 54 age group are the single 10-year age cohort representing the majority of recreational property owners.

Rates of recreational property ownership differ quite significantly by age group. Comparing the age distribution of recreational property owners with that of household heads as a whole, ownership rates increase from a low of 3.2 percent among those under 25 years of age to a high of 13.7 percent among those 45 to 54 years of age. However, as retirement approaches and then occurs, many households either divest themselves of recreational property or sell their primary home and move into their second home. As a result, ownership rates decline to 6.0 percent among households 65 and older. The higher rate of recreational property ownership among mature households has important implications for the future, due to the aging of the "baby boom" generation.

Most recreational property owners are not especially affluent. Over half (55 percent) have household incomes of less than $50,000 annually. The median income of recreational property owners is only $46,500 annually, or less than $10,000 above the median for all married couple households. However, the rate of recreational property ownership increases dramatically with income. Only about two percent of households with incomes under $20,000 annually own recreational property. But among households with incomes of $100,000 or more nearly one in three own.

Prior studies of recreational property ownership found strong correlations with income; however, despite the trend to higher rates of ownership among the affluent, they found most recreational property owners were middle-class.

Number of Interests and Shares of Total Property

The average household which owns recreational property has an interest in an average of 1.25 different properties. Fully 17.2 percent of recreational property owners have interests in more than one property. This compares with 4.7 percent from the 1967 Census Bureau study of owners who had an interest in more than one second home.

Because sharing of recreational property ownership eases the financial burden, 30.5 percent of households who own any recreational property share the ownership of at least one of their properties with at least one other household. Fully 18 percent of ownerships in recreational properties represent less than a five percent share of the unit or property; one-fifth (20.1 percent) of all recreational property interests represent less than a 25 percent stake in the unit or property; and, on average, each recreational property interest held by U.S. households represents a 74.5 percent share of the unit or property.

vacation home or cabin still represents the most widely held type of recreational property interest, at 41.5 percent. Attached units such as condominiums and townhomes are the second most widely held type of recreational property interest, at 15.9 percent. This is one of the new products which has become much more prevalent in the last 20 years. Vacant homesites and acreage are the third most widely held form of recreational property, at 15.1 percent. This is a dramatic drop from the early 1970s when much of rural American was being carved into recreational subdivisions.

Timeshares represent 12.7 percent of all recreational property interests. They are normally sold in one-week increments, but a "timeshare interest" represents one or more weeks at a single resort, no matter how many weeks the household may own at that resort. Recreational property owners may own more than one recreational property, and the properties may be of differing types. For example, while only 12.7 percent of all recreational property interests are timeshares, fully 15.6 percent of all recreational property owners hold a timeshare interest.

Purchase Price and Current Value of Recreational Property

The median price paid for recreational properties at the time first acquired was just $13,000 per interest. This low purchase price reflects properties which have been held for long periods of time, as well as the many households who own timeshares or other partial shares, campsites, small lots, and other low-cost types of properties. In addition, 12.5 percent of recreational property owners inherited one or more of their interests.

The median estimated current market value of recreational property interests is $45,000 per interest. Many interests represent only partial shares in the property and include low-cost products such as campsites and small lots. Based upon the difference between the current value and purchase price, it is clear that recreational property owners, as a group, have seen significant appreciation in the value of their property over the course of their ownership. In fact, the average gain per household has been $61,544 over an average ownership period of 10.6 years.

The aggregate value of all recreational properties in the U.S. is estimated at about $892 billion (7.6 percent ownership rate x 94.2 million households x $131,036 average market value per household for all households owning recreational property x 95.1 percent located in U.S.). Another $46 billion in recreational property is owned by U.S. residents but located in territories or foreign countries. This represents 4.9 percent of total recreational property market value held by U.S. residents.

Mortgages on Recreational Properties

Many recreational properties were purchased years ago, or inherited. Others are of relatively low value, and so were purchased with cash. Timeshares and campground interests typically are purchased on time contracts, but with terms of seven years or less. For these reasons, only 28.5 percent of all recreational properties are mortgaged; but, 35 percent of households who own a recreational property have at least one of their interests mortgaged.

Whether a recreational property is mortgaged varies greatly with length of ownership. For example, fully 41 percent acquired within the past five years have a mortgage, as compared with 14 percent acquired at least 11 years ago.

Due to reduction of debt with the passage of time and the moderate value of many recreational property interests, outstanding mortgage balances are relatively modest. The median outstanding balance on recreational property mortgages, per interest, is just $12,000. Again, this is primarily because many properties are partial interests: figures shown represent the share of debt borne by a single household, not all households involved in the purchase. Also, because some households have owned for many years, many recreational properties which are mortgaged may be nearly paid off.

Property Taxes

The median property tax bill per recreational property interest was just $350 during the most recent tax year prior to the survey. However, due to some properties with high values, the average recreational property was billed for

$1,335. This represents $12 per $1,000 of market value (based on a $108,810 average market value per interest). The total property tax contribution of all recreational property owners nationwide was some $11.9 billion last year.

Use of Recreational Properties

On average, recreational properties experience relatively little actual use. Total average usage comes to only 57.9 nights per year unit; 16 percent annual occupancy, or just over eight weeks of use. Usually, 26.9 nights were by someone such as the owner, a friend, or relative staying for free, and 31 nights were by renters.

Multiplying the 6.7 million recreational properties owned by U.S. residents times 31 nights per year of rental use results in a total of 208 million rental nights in privately owned recreational properties. This is in addition to any free nights that relatives, friends, and business associates may have spent at the property. Thus, privately owned recreational properties clearly contribute significantly to the recreational access of Americans.

Future Potential Demand for Recreational Property

The net number of households owning recreational property increased by an average of about 250,000 annually between 1967 and 1973. It then dropped to about 135,000 annually from 1973 to the present. Nearly half of the increase between 1973 and 1990 represents timeshare buyers. Second home units increased by an average of about 133,000 annually between 1967 and the present.

Unfortunately, pre-1990 counts for recreational properties as a whole are unavailable, as well as second home counts for the interim of 1973 to the present. Therefore, it is not possible to calculate accurately whether recreational property and second home sales are speeding up or slowing down as compared with the 1973-1990 overall pace.

Another potential source of industry growth projections might be the purchase intentions of households. Some 26.2 percent of existing households who do not currently own recreational property, or some 22.8 million, indicate they have some chance of purchasing recreational property over the next ten years. However, comparisons between intentions and actual purchase behavior from past surveys concerning recreational property and other products suggest relatively few of these households will actually purchase; probably fewer than one-fifth.

Assuming that each age group will continue to exhibit its current rate of recreational property ownership, due to the aging of the baby boom generation into the prime years for recreational property purchases, this would result in about 150,000 new recreational property owners each year, on average, over the next decade.

However, this projection of 150,000 new recreational property owners annually is probably conservative. It represents a pace only slightly above that for second homes alone for the 1973-1990 period. Nearly this many households have purchased timeshares alone during the past several years. And, of course, this projection does not take into account changes in fashionability of second home ownership, availability and cost of financing, economic trends such as higher employment or increased household income, land availability, affordability of new offerings such as timeshares and short duration club memberships, increased penetration of major hotel chains into the resort development arena, or other factors which may have a significant positive or negative impact on demand for recreational property.

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by
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Table 1
Characteristics Of Recreational Property Owners

Characteristic	Response
Proportion of All Households Who Own Recreational Property	7.6%
Region of Residence	
West	23.5%
South	32.0%
North Central	22.4%
North East	22.0%
Household Type	
Married	78.3%
Unmarried couple	2.8%
Single male	6.9%
Single female	8.0%
Other	4.0%
Housing Tenure	
Owners	88.8%
Renters	11.2%
Number of Children 18 Years of Age or Younger Living at Home	
None	63.4%
One	18.0%
Two	12.6%
Three or more	6.0%
Age of Household Head	
Under 25	2.1%
25 to 29	4.8%
30 to 34	5.9%
35 to 44	22.4%
45 to 54	27.5%
55 to 64	20.3%
65 to 74	12.6%
75 or over	4.4%
Number of Recreational Interests Owned	
One	82.8%
Two	11.5%
Three or more	5.7%

Table 1 (Continued)
Characteristics Of Recreational Property Owners

Characteristic	Response
Household Income	
Under $10,000	1.6%
$10,000 to $19,999	6.5%
$20,000 to $29,999	12.5%
$30,000 to $39,999	16.8%
$40,000 to $49,999	17.6%
$50,000 to $59,999	11.5%
$60,000 to $74,999	13.2%
$75,000 to $99,999	7.3%
$100,000 to $199,999	11.8%
$200,000 or more	1.5%
Approximate Median	$46,500
Proportion Owned of Each Recreational Property Unit In Which Household Holds an Interest	
Less than 5% (typically timesharing)	18.0%
5% to 24%	2.1%
25% to 49%	2.5%
50% to 99%	8.1%
100%	69.4%
Proportion of Recreational Property Owners Who Hold At Least One Partial Interest	30.5%
Types of Interests Held by Recreational Property Owners	
Detached house or cabin	51.0%
Vacant site	18.4%
Attached unit, condo or townhome	19.6%
Timeshare weeks	15.6%
Camping site or campground membership	10.2%
Mobile home	3.8%
Other	4.1%
Reasons for Recreational Property Ownership	
Recreational or vacation use	62.5%
Investment or income	37.5%
Inherited	12.5%
Seasonal living	6.3%
Trying to sell but unable so far	6.3%
Future retirement or other full-time living	6.3%

Table 2
Economics Of Recreational Property Ownership

Characteristic	Response
Purchase Price Per Recreational Property Interest	
Under $5,000	14.7%
$5,000 to $9,999	24.9%
$10,000 to $24,999	19.2%
$25,000 to $49,000	12.9%
$50,000 50 $99,999	16.8%
$100,000 to $199,999	8.1%
$200,000 or more	3.6%
Median	$13,000
Total Price Paid for All Recreational Property Interests Owned by Household	
Median	$15,000
Estimated Current Market Property Value per Recreational Interest	
Under $5,000	5.6%
$5,000 to $9,999	13.0%
$10,000 to $24,999	17.6%
$25,000 to $49,000	16.4%
$50,000 50 $99,999	16.4%
$100,000 to $199,999	19.8%
$200,000 or more	11.1%
Median	$45,000
Current Market Value of All Recreational Property Interests Owned by Household	
Median	$45,000
Recreational Property Interests With Mortgage	28.5%
Outstanding Mortgage Balance for Those Properties With a Mortgage	
Under $5,000	26.6%
$5,000 to $9,999	13.9%
$10,000 to $24,999	21.5%
$25,000 to $49,000	16.5%
$50,000 50 $99,999	13.9%
$100,000 to $199,999	6.3%
$200,000 or more	1.3%
Median	$12,000
Households with Mortgage on at Least One Recreational Property Interest	
Yes	35.0%
No	65.0%

Table 2 (Continued)
Economics Of Recreational Property Ownership

Characteristic	Response
Outstanding Mortgage Balance on Recreational Properties for All Interests	
Median (for properties with a mortgage)	$12,000
Amount of Most Recent Annual Tax Bill Per Recreational Property Interest	
Under $100	21.0%
$100 to $249	20.1%
$250 to $499	15.6%
$500 to $999	19.2%
$1,000 to $1,999	12.1%
$2,000 or more	12.1%
Median	$350
Amount of Most Recent Annual Recreational Property Tax Bill per Household	
Median	$400
Number of Nights During Prior 12 Months Recreational Property Interest Was Occupied by Persons Not Paying Rent	
0	32.4%
1 to 7	18.2%
8 to 14	9.9%
15 to 30	15.9%
31 to 60	11.2%
Over 60	12.4%
Median	10 Nights
Number of Nights During Prior 12 Months Recreational Property Interest Was Occupied by Renters	
0	83.7%
1 to 7	2.2%
8 to 14	0.4%
15 to 30	2.0%
31 to 60	1.3%
Over 60	10.2%
Median	0 Nights

U.S. Economic Outlook: August 1990

	90.1	90.2	90.3	90.4	91.1	91.2	91.3	91.4	1988	1989	1990	1991	1992
U.S. Economy													
Annual Growth Rate													
Real GNP	1.7	1.2	1.4	-1.2	-0.6	1.5	1.5	3.0	4.5	2.5	1.1	0.5	3.1
Industrial Production	0.6	3.6	1.5	-1.4	-0.1	0.8	2.1	4.3	5.4	2.6	1.0	0.8	4.2
Civilian Employment	1.0	0.7	0.2	-0.9	-0.7	-0.1	0.3	0.6	2.3	2.0	0.7	-0.2	1.1
GNP Inflation Index	4.8	4.4	4.9	4.6	5.2	4.6	4.3	3.5	3.3	4.1	4.3	4.7	3.5
Consumer Prices	8.1	3.7	5.2	6.4	6.1	5.6	5.2	4.1	4.1	4.8	5.2	5.6	3.8
Value of the U.S. Dollar	-16.0	-2.0	-16.5	-10.9	-9.7	-6.8	-1.4	4.6	-4.3	6.2	-8.5	-8.0	4.5
Percent													
Mfg. Capacity Utilization	82.6	82.6	82.8	82.0	81.1	80.6	80.4	80.6	83.9	83.9	82.5	80.7	81.3
Civilian Unemployment	5.3	5.3	5.5	5.9	6.2	6.4	6.5	6.5	5.5	5.3	5.5	6.4	6.2
Percent of GNP													
Federal Tax Receipts	20.1	20.2	20.2	20.3	20.7	20.7	20.7	20.7	20.0	20.2	20.2	20.7	20.7
Federal Expenditures	23.2	23.1	22.9	22.9	23.1	22.9	22.8	22.6	22.9	22.8	23.0	22.9	22.3
Federal Budget Deficit	-3.1	-2.9	-2.7	-2.6	-2.4	-2.2	-2.1	-1.9	-2.9	-2.6	-2.8	-2.2	-1.5
Interest Rates, Percent													
Federal Funds Rate	8.3	8.2	7.8	7.4	7.3	7.3	7.5	7.5	7.6	9.2	7.9	7.4	7.5
3-Month T-Bill Rate	7.8	7.7	7.3	7.0	6.8	6.8	7.0	7.1	6.7	8.1	7.5	6.9	7.1
Prime Rate	10.0	10.0	9.8	9.5	9.4	9.3	9.3	9.3	9.3	10.9	9.8	9.3	9.3
Discount Rate	7.0	7.0	6.9	6.8	6.6	6.5	6.5	6.5	6.2	6.9	6.9	6.5	6.5
Corporate AAA Bond Yield	9.2	9.4	9.2	8.9	8.6	8.5	8.5	8.5	9.7	9.3	9.2	8.5	8.5
30-Year Government Bond Yield	8.4	8.7	8.4	8.1	7.9	7.8	7.7	7.7	9.0	8.4	8.4	7.8	7.8
Mortgage Rates, Percent													
30-Year Fixed Rate	10.1	10.3	10.1	9.8	9.5	9.3	9.3	9.3	10.3	10.3	10.1	9.4	9.4
1-Year Adjustable	8.4	8.6	8.4	8.3	8.3	8.2	8.2	8.2	8.5	9.3	8.4	8.2	8.3
Home Sales & Starts													
Thousands													
Total Single-Family Sales (Single-family resales plus 97% of single-family starts)	4,474	4,191	4,152	4,075	4,103	4,154	4,213	4,265	4,647	4,447	4,222	4,186	4,349
Existing Single-Family Sales	3,423	3,323	3,299	3,268	3,262	3,268	3,303	3,338	3,594	3,467	3,328	3,295	3,408
New Single-Family Sales	592	548	539	532	528	531	536	547	676	654	553	535	561
Housing Starts	1,454	1,199	1,173	1,124	1,171	1,238	1,275	1,306	1,491	1,386	1,237	1,247	1,337
Single-Family Units	1,083	894	879	832	867	913	938	956	1,086	1,010	922	918	970
Multi-Family Units	371	305	294	291	304	325	337	350	405	377	315	329	367
2-4 Family Units	43	44	43	42	44	47	49	51	59	55	43	48	53
5+ Family Units	328	261	251	249	260	278	288	300	347	321	272	281	313
Mobile Homes Shipped	196	191	188	178	181	187	190	195	218	199	188	188	202
Percent change -- Year Ago													
Total Single-Family Sales	-2.3	-2.6	-5.8	-9.3	-8.3	-0.9	1.5	4.7	0.4	-4.3	-5.0	-0.9	3.9
Existing Single-Family Sales	-3.5	-0.5	-4.2	-7.6	-4.7	-1.7	0.1	2.2	2.4	-3.5	-4.0	-1.0	3.4
New Single-Family Sales	-5.6	-13.7	-22.9	-18.4	-10.8	-3.3	-0.5	2.8	0.8	-3.3	-15.4	-3.1	4.7
Housing Starts	-0.3	-11.4	-12.3	-16.6	-19.5	3.2	8.8	16.2	-8.6	-7.0	-10.7	0.8	7.2
Single-Family Units	0.2	-9.8	-11.7	-15.8	-20.0	2.1	6.8	14.8	-5.9	-7.0	-8.7	-0.4	5.6
Multi-Family Units	-1.6	-15.8	-14.2	-19.0	-18.2	6.6	14.7	20.2	-14.9	-7.1	-16.2	4.3	11.4
2-4 Family Units	-2.7	-16.9	-23.7	-20.6	1.9	6.6	14.7	20.2	-10.0	-5.7	-22.1	10.8	11.4
5+ Family Units	-1.4	-15.6	-12.3	-18.7	-20.9	6.6	14.7	20.2	-15.7	-7.3	-15.2	3.3	11.4
Median Home Prices													
Thousands of Dollars													
Existing Home Prices	95.9	96.2	97.0	97.5	97.4	97.7	98.3	98.7	89.2	92.9	96.7	97.8	100.3
New Home Prices	123.2	129.3	130.3	131.1	131.7	132.9	133.6	134.5	113.4	120.4	128.5	133.2	137.6
Percent Change - Year Ago													
Existing Home Prices	5.2	3.5	2.2	5.2	1.6	1.6	1.4	1.3	5.0	4.2	4.0	1.2	2.6
New Home Prices	4.4	8.2	8.9	5.4	6.9	2.8	2.5	2.5	8.3	6.2	6.7	3.6	3.3

Source: Forecast produced using Laurence H. Meyer & Associates' model of the U.S. economy
Assumptions and simulations by Dr. John Tuccillo and Robert Barr.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE

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OUTLOOK

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The economic expansion remains on its knees -- down but not out. The first reports covering the period since the Persian Crisis broke out show a slowing economy: down in August were industrial production, capacity utilization, and retail sales. Among the economic variables up during August: long-term interest rates and consumer and producer prices.
- The current NAR forecast calls for a mild recession beginning in the fourth quarter of 1990. By the third quarter of 1991, a modest recovery will have begun. In terms of annual rates, the economy is expected to grow 1.1 percent in 1990 and show no growth in 1991. Growth will resume at a 2.4 percent rate in 1992. This compares to a 3.9 percent average for economic growth between 1982 and 1989.
- Housing starts continued to struggle in July, falling for the tenth time in the past twelve months. The annual rate for July was 1,148,000 units, the lowest level since the end of the last recession in October 1982. The figure was 19.4 percent below the July 1989 start rate. Housing starts are expected to reach bottom during the fourth quarter of 1990, when the rate of starts is projected at 1,134,000 units.
- The rate of new homes sold declined 2.3 percent in July and stood at only three-quarters of the rate of sales in July 1990. This marks the ninth month in the past year that the sales rate has fallen. Sales of existing homes, meanwhile, put together back-to-back monthly sales gains for the first time in almost a year. In July, the sales rate grew 3.3 percent.
- While the housing market is in a slump, it isn't moribund. Both the Northeast and the South reversed decreases in the existing homes sales rate in July by picking up 14.3 percent and 6.9 percent, respectively. The South's 1,400,000-unit annual rate during July was stronger than the region's annual rates in both 1988 and 1989. The West, however, was about 16 percent off in July from its 1989 performance.

IN THIS ISSUE

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Applied Astrology

by
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Economic forecasting used to be so easy. For most of the Eighties, you put the machine on automatic pilot, called for continued growth, moderate inflation and marginal changes in interest rates, and hit the golf course. Now it's *work*. Until the events in the Gulf clarify, until the budget summiteers come down from the mountain, and until the Fed makes up its mind about whether it's fighting inflation or recession, any forecast is more religion than science. Astrology comes from the East, and the events in the Middle East have made economists revert to being astrologers.

Clearly, the future of this economy will depend significantly on the resolution of our face-off with Iraq. In the most probable case, we will be involved in a protracted stalemate that will tie up resources in maintaining a desert presence. Oil prices will stabilize in the $25-30 range, pushing inflation up and growth down. Even increased military spending will be insufficient to avert recession. The disaster scenarios--in both human and economic terms--involves a fully shooting war that doubles oil prices and spawns a deep and prolonged recession.

But the oil shock only sets the stage. The severity and duration of the coming recession--in fact, if it comes at all--depend on how public policy, monetary and fiscal, operate. The budget summiteers from Congress and the Administration retired to Andrews Air Force Base and returned with a plan to move the deficit closer to the Gramm-Rudman targets. Implementation will be difficult because of the slowing economy; in fact, the deeper the deficit cuts, the deeper and more probable is recession. But ultimately, that is the best policy. If this economy is to recapitalize in the Nineties, the oppressive weight of Federal debt must be removed from the financial market.

The Federal Reserve faces a similar, if more delicate, dilemma. Easing monetary policy could avert a recession that it desperately wishes to avoid. But doing so will ratify higher oil prices into higher inflation rates which the Fed also wants to avoid. Added into this mix is the fact that the continued attraction of the foreign capital on which we have come to depend requires higher interest rates and thus tight money. The experience of the Eighties suggests that in the long run dropping the inflation rate produces a stronger economy than leaning against recession. The Fed knows this and will act accordingly, easing only slightly to mitigate the severity and duration of recession while avoiding the loss of foreign capital and exploding inflation.

The final determinant of events is the length of time the banking system and its regulators continue to view real estate as an investment to avoid. On the heels of the thrift crisis, bank regulators labelled construction and development lending as excessively risky. Banks took the message, and the example of their thrift brethren, to heart, and cut back significantly on real estate lending. The result has been a general inability of builders and developers to obtain the credit necessary to undertake projects. And this shows up in plummeting housing starts and an increasing squeeze on viable commercial real estate developments.

This, too, is economic policy. It's not taxes or spending--like fiscal policy--and it's not control of monetary growth. Rather it's the allocation of credit by persuasion, something generally termed "jawboning." Policy makers--in this case bank regulators--are channelling credit away from real estate by an implicit use of regulatory authority. When the examiners hit a bank and force a general write-down of real estate loans because "the market is declining," the word spreads and it's not necessary to repeat the process at a second institution. In the biblical story, Samson slew the Philistines with the jawbone of an ass; now the ass is wielding the jawbone.

So the forecaster is in a quandary. Besides the potential for war and peace in the Gulf, three major policy questions cloud the economic outlook. How the answers to these questions evolve will tell us if we can avert recession, and if not, how deep the slump will be. Oh, for the good old days of the late Eighties when economic prognostication was so secure. To paraphrase the Eagles:

> *My, oh my, you sure know how to arrange things*
> *You planned it all so well, so carefully*
> *Funny how you know life didn't change things*
> *You're still the same old gang you used to be.*

Outlook for the Economy and Real Estate

The economic expansion remains on its knees -- down but not out. The referee's count can be heard in the gloomy economic reports released recently, such as August's declines of 0.2 percent in industrial output and 0.6 percent in retail sales. Consumers and investors remain uncertain about government fiscal policy and oil prices, which have topped $33 on the spot market.

Although good news from either arena may allow the economy to avert a recession, growth is going to remain well below trend over the next few quarters. The current NAR forecast calls for a mild recession beginning in the fourth quarter of 1990 and ending the following quarter. After these two quarters of negative growth, zero growth is expected in the second quarter of 1991. By the third quarter, a modest recovery will have begun. In terms of annual rates, the economy is expected to grow 1.1 percent in 1990 and show no growth in 1991. Growth will resume at a 2.4 percent rate in 1992. As a point of comparison, growth between 1982 and 1989 averaged 3.9 percent.

If Not a Recession, Then a Recessionary Climate

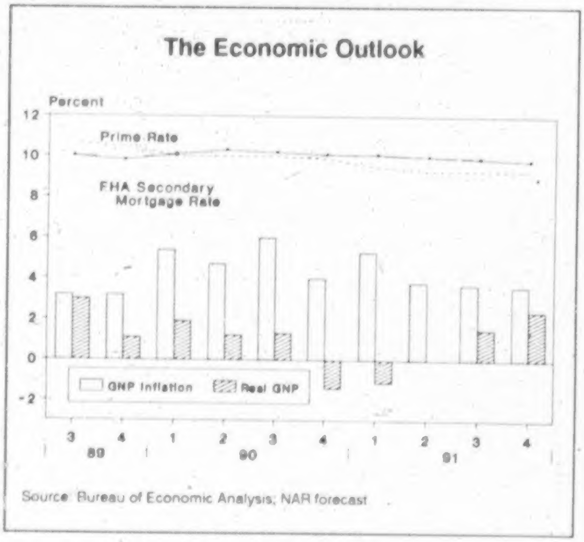
Although the numbers presented in this *Outlook* are a bit harsher than those of last month, the underlying story has not changed: The economy is stringing together several quarters of extremely slow growth. In fact, growth in some of those quarters is likely to be negative. No matter whether the official statistics place the economy in a recession or not, the current economic climate feels like a recession to many regions, industries, and individuals.

The problems with the economy are not rooted in the Persian Gulf crisis. Many important economic figures were showing fatigue before the Iraqi invasion: Export growth was slowing, consumer spending was down, and housing was slumping. Nevertheless, Saddam Hussein's actions have gravely imperiled whatever chances the economy has of skirting a recession.

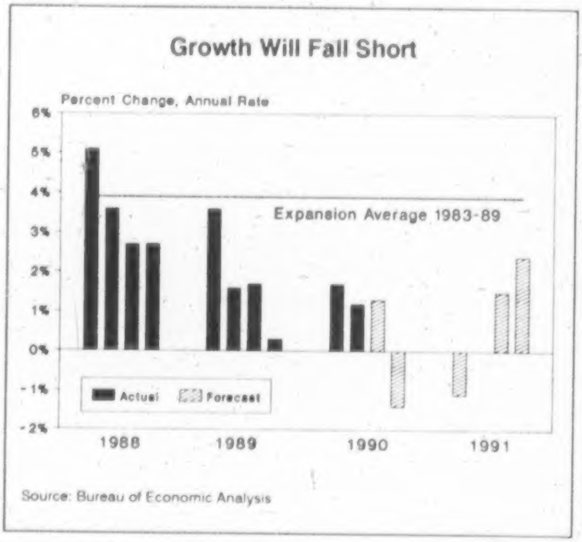
Employment Growth Continues to Slide

Job losses in manufacturing industries continued in August with 45,000 more workers placed off manufacturing payrolls. Since January 1989, this sector has shed 456,000 jobs and, year-to-date, employment is falling at a 1.6 percent annual rate. Employment in services has not been spared as growth has been cut in half over the past two years. In 1988, employment in private nonmanufacturing industries -- such as transportation, finance, communications, retail sales, health services -- rose by 4.0 percent. So far in 1990, job growth has come at only a 2.1 percent annual rate. Falling job growth pulled up the unemployment rate in August to 5.6 percent, up from 5.2 percent in June.

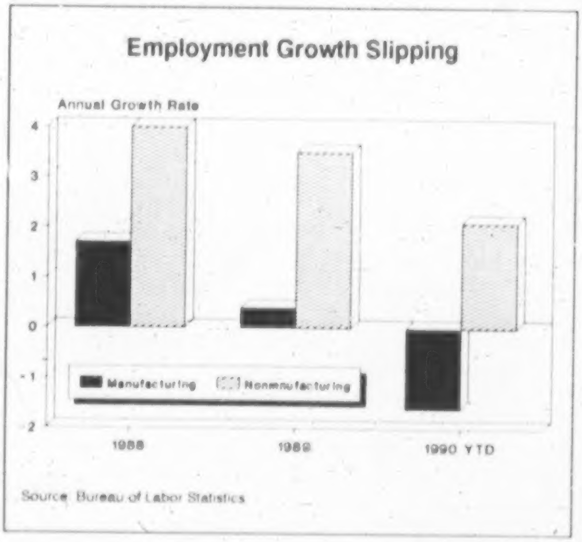
Consumers appear to be keeping their spending in check. The University of Michigan's index of consumer expectations, which had spent most of 1990 in the mid-80s, plunged to 62.9 in August from July's 77.3 level. Credit card debt rose a robust $3.8 billion in July, but about half of that may have been interest rate charges as households found it more difficult to pay off their outstanding balances. Nevertheless, auto sales held up well during the first ten days of September.


The Economic Outlook

Source: Bureau of Economic Analysis; NAR forecast


Growth Will Fall Short

Source: Bureau of Economic Analysis


Employment Growth Slipping

Source: Bureau of Labor Statistics

Long-Term Rates Up to Cover Inflation Risk

The jump in oil prices has been traced out by a jump in long-term interest rates, as shown on the chart at the right. While contract oil prices are expected to remain in the $25 per barrel range, interest rates are expected to ease as economic weakness becomes more pervasive. The yield curve chart at the middle right shows how yields have changed along the spectrum of maturities on government bonds since the Iraqi invasion. Two yield curves are shown: one which shows June's averages for eight different maturities, and another which shows the averages for the week ending September 14. Short-term interest rates have fallen while rates on longer-term obligations have risen. This dichotomy is due to increased demand for short-term instruments as stock market prices fall and uncertainty about the health of the economy rises. Yields, meanwhile, have risen on long-term instruments since they are much more vulnerable to inflation. The increase in the long-term bond yield is a measure of the extra return required in the face of higher inflation. By the first quarter of 1991, both long- and short-term rates are expected to fall relative to their current positions.

Mortgage rates, consequently, have also risen over the past six weeks despite the weak housing market. At the end of July, rates on 30-year conventional mortgages stood at 9.98 perecent; by mid-September the rate stood at 10.13 percent. After staying close to the 10 percent range during most of 1991, rates are expected to average 9.5 percent in 1992.

The First Jump in the Inflation Data

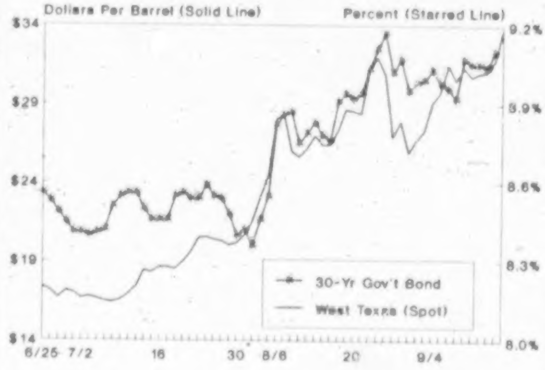
The Producer Price Index rose sharply in August, as expected. The monthly change from July was 1.3 percent, or 16.8 percent at an annual rate. The initial impact to the price system of higher oil prices was recorded in the Crude Materials component of the PPI. Here, at the epicenter of the price shock, prices were up almost 10% for the month. These higher prices are feeding through to other areas, and consequently the next several PPI and Consumer Price Index reports will be unpleasant.

The short-term outlook for inflation depends largely upon the course of oil prices. With a weak economy and monetary policy aimed at containing inflation, double-digit inflation is not expected. The steepest quarterly rise in the CPI over the forecast horizon is 7.3 percent during the fourth quarter of 1990.

Fiscal and Monetary Policies In A Stalemate

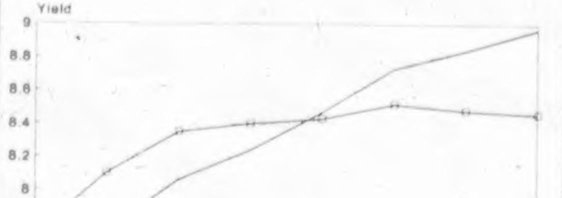
Government policy, meanwhile, has been gridlocked. With an eye on the inflation numbers, the Federal Reserve is reluctant to loosen monetary policy until, as Chairman Greenspan put it, "a credible, long-term, enforceable budget agreement" is enacted. Yet the budget negotiators appear to be making little progress, even under the shadow of automatic spending cuts to go into effect on October 1. The outlook assumes that the conferees agree on a $25 billion deficit-reduction package -- only half of their stated goal, but enough to keep the government running full-time. With the Fed waiting for the Administration and Congress before easing monetary policy, the risk of a recession grows.

Bond Yields Follow Oil Prices



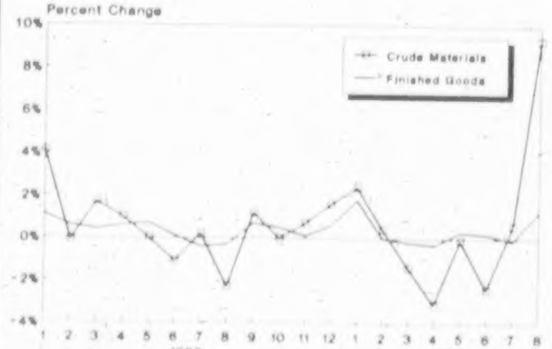
Source: Federal Reserve Board, Data Resources

The Yield Curve Steepens



Source: Federal Reserve Board

The First Inflation Salvo



Source: Bureau of Labor Statistics

HOUSING STARTS

(Seasonally Adjusted Annual Rates, in Thousands)

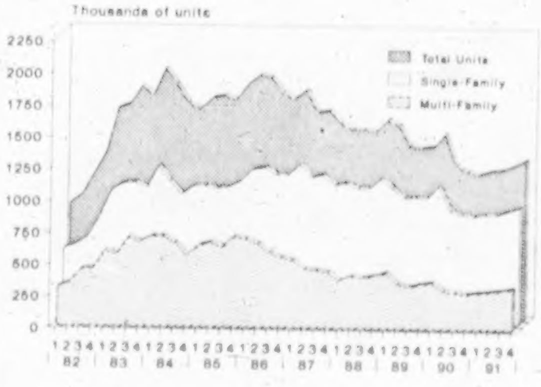
National Data

	Total	SF	2-4	5+
Jul 1989	1,424	1,029	58	337
Mar 1990	1,307	996	35	276
Apr 1990	1,216	898	53	265
May 1990	1,206	897	36	273
Jun 1990	1,179	885	37	257
Jul 1990	***1,148***	***873***	***32***	***243***
Annual Averages:				
1988	1,488	1,081	59	348
1989	1,376	1,003	55	318
Percent Changes in July 1990 since:				
Jul 1989	-19.4	-15.2	-44.8	-27.9
Jun 1990	-2.6	-1.4	-13.5	-5.4

Regional Data

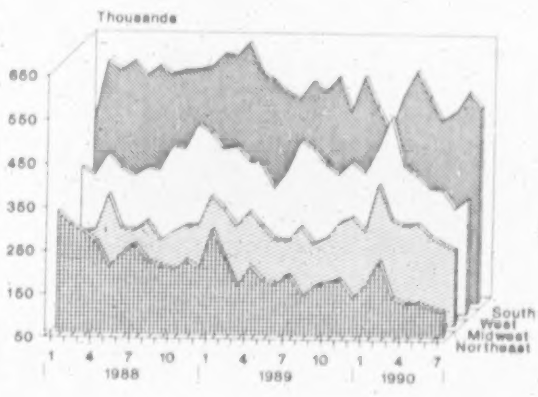
	Northeast	Midwest	South	West
Jul 1989	190	276	531	427
Mar 1990	139	280	520	368
Apr 1990	124	284	469	339
May 1990	127	256	487	336
Jun 1990	114	238	534	293
Jul 1990	***108***	***225***	***498***	***317***
Annual Averages:				
1988	243	274	574	405
1989	184	272	537	396
Percent Changes in July 1990 since:				
Jul 1989	-43.2	-18.5	-6.2	-25.8
Jun 1990	-5.3	-5.5	-6.7	8.2

Source: Bureau of the Census; Construction Reports, Series C20



Housing Starts

Source: Bureau of Census; Real Estate Outlook forecast



Housing Starts by Region

Source: Bureau of Census

Housing starts continued to struggle in July, falling for the tenth time in the past twelve months. The annual rate for July was 1,148,000 units, the lowest level since the end of the last recession in October 1982 and 19.4 percent below the July 1989 figure. This follows the second quarter's rate of 1,200,000 units, which itself was a steep 17.4 percent decline from the first quarter's rate.

Housing starts are projected to reach bottom in the fourth quarter of 1990 at a 1,134,000 annual rate. Slightly lower interest rates, largely a result of the slumping economy, should give a modest boost to housing starts during 1991. By the fourth quarter of 1991, starts should be at a 1,254,000-unit pace, and economic recovery in 1992 is expected to spur housing starts to 1,332,000 units.

Multi-family units continue to bear the brunt of the decline in housing starts. In July, multi-family units were started at a 275,000-unit annual rate, 30 percent below the rate in July 1989. The current NAR forecast calls for multi-families to reach its nadir in the fourth-quarter of 1990 with a 284,000-unit rate. This would place multi-families below the low point reached during the last recession.

During July, all four regions remained below their rates for housing starts of one year ago. The biggest decline was recorded by the Northeast, down 43.2 percent. Only the West posted an increase in June relative to May, gaining 8.2 percent after a 12.8 percent loss the month before.

NEW HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

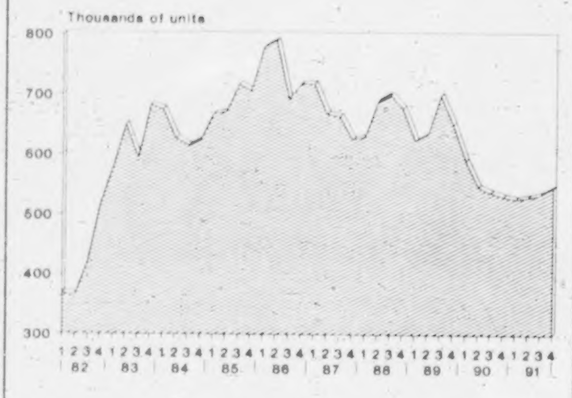
		Mo. Ago % Chg.	Yr. Ago % Chg.
Jul 1989	741	14.7	5.7
Aug 1989	719	-3.0	1.0
Sep 1989	638	-11.3	-7.7
Oct 1989	636	-0.3	-11.4
Nov 1989	687	8.0	5.7
Dec 1989	633	-7.9	-5.4
Jan 1990	613	-3.2	-12.9
Feb 1990	606	-1.1	-2.7
Mar 1990	558	-7.9	0.4
Apr 1990	533	-4.5	-12.6
May 1990	536	0.6	-17.7
Jun 1990	561	4.7	-13.2
Jul 1990	***548***	***-2.3***	***-26.0***
Annual Averages:			
1988	676		0.8
1989	654		-3.3

Regional Data

	Northeast	Midwest	South	West
Jul 1989	103	127	281	229
Jan 1990	94	104	226	189
Feb 1990	68	84	265	189
Mar 1990	84	94	221	159
Apr 1990	86	90	209	148
May 1990	71	93	215	157
Jun 1990	89	94	237	142
Jul 1990	***80***	***96***	***237***	***135***
Annual Averages:				
1988	101	98	271	206
1989	90	103	258	202
Percent Changes in July, 1990 since:				
Jul 1989	-22.3	-24.4	-15.7	-41.0
Jun 1990	-10.1	2.1	0.0	-4.9

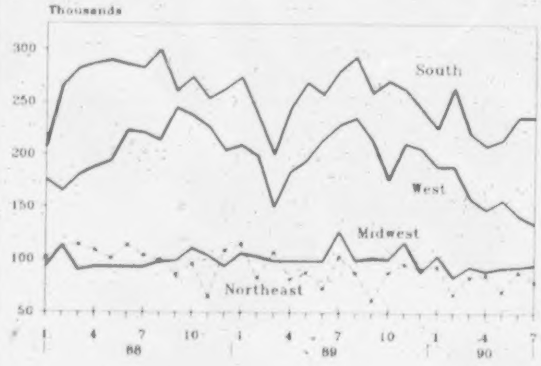
Source: Bureau of the Census; Construction Reports, Series C25

New Home Sales



Source: Bureau of Census; Real Estate Outlook forecast

New Home Sales by Region



Source: Bureau of Census

The rate of new homes sold declined 2.3 percent in July and stood at only three-quarters of the rate of sales in July 1990. This marks the ninth month in the past year that the sales pace has fallen. During the second quarter, new homes were sold at a 543,000-unit annual rate, 8.2 percent below the first quarter's rate.

For the next few quarters, uncertainty about the economy will dampen new home sales activity. The pace is expected to drop to 524,000 units during the second quarter of 1991 before recovering somewhat to 534,000 units in the fourth quarter. The annual figure for 1991 is projected to be 528,000 units, almost 20 percent below the 1989 figure. Although 1992 will be a year of recovery, the annual rate will stand 16 percent below the 1989 figure.

The Northeast's big increase in June, initially estimated at 40 percent, was scaled back to 25.3 percent, according to revised figures. The spurt of activity was unsustained in July, when the pace slipped 10.1 percent below June's rate. The sales rate in the Midwest gained ground in July, improving 2.1 percent over June. Meanwhile, the sales rate held even in the South and dipped almost 5 percent in the West.

Compared to the first seven months of 1989, all four regions recorded significant declines in sales activity through the first seven months of 1990. The West fell the furthest, down 19 percent. The Northeast was down 12 percent during the same period, the Midwest was down almost 11 percent, and the South was off by 9 percent.

EXISTING SINGLE-FAMILY HOME SALES

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

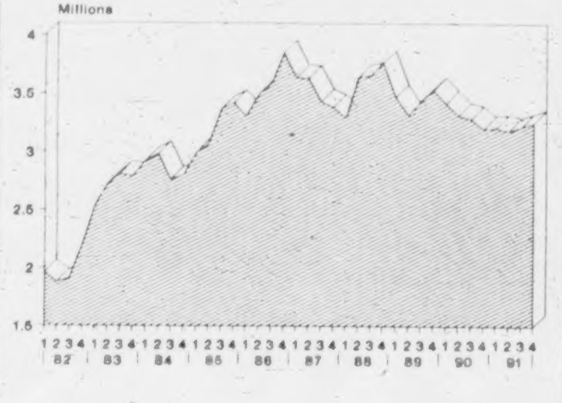
		Mo. Ago % Chg.	Yr. Ago % Chg.
Jul 1989	3,380	1.5	-7.4
Aug 1989	3,440	1.8	-6.8
Sep 1989	3,510	2.0	-3.8
Oct 1989	3,490	-0.6	-5.2
Nov 1989	3,560	2.0	-4.0
Dec 1989	3,560	0.0	-9.2
Jan 1990	3,470	-2.5	-5.2
Feb 1990	3,400	-2.0	-4.2
Mar 1990	3,400	0.0	-0.9
Apr 1990	3,330	-2.1	-3.2
May 1990	3,300	-0.9	1.5
Jun 1990	3,330	0.9	0.0
Jul 1990	***3,440***	***3.3***	***1.8***
Annual Averages:			
1988	3,594		-1.9
1989	3,467		-3.6

Regional Data

	Northeast	Midwest	South	West
Jul 1989	520	940	1310	570
Feb 1990	560	890	1310	650
Mar 1990	500	910	1360	630
Apr 1990	520	920	1300	580
May 1990	520	880	1320	570
Jun 1990	490	960	1310	580
Jul 1990	***560***	***930***	***1400***	***520***
Annual Averages:				
1988	669	929	1348	643
1989	590	931	1320	617
Percent changes in July 1990 since:				
Jul 1989	7.7	-1.1	6.9	-8.8
Jun 1990	14.3	-3.1	6.9	-10.3

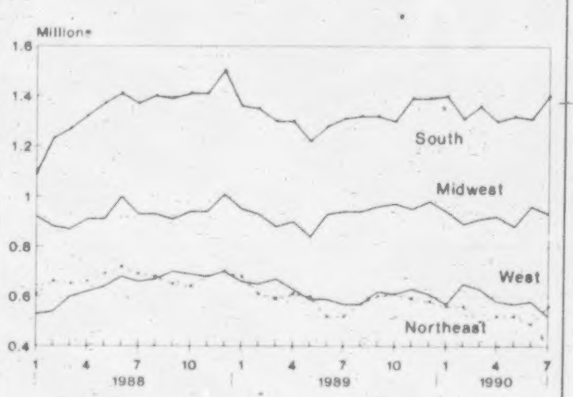
Source: Bureau of the Census; Construction Reports, Series C25

Existing Home Sales



Source: NAR Economics & Research; Real Estate Outlook forecast

Existing Home Sales by Region



Source: NAR Economics & Research

For the first time since September 1989, the sales rate for existing homes posted back-to-back gains in July. The 3.3 percent increase followed June's 0.9 percent gain, leaving July's rate at 3,440,000 units. This placed sales 1.8 percent ahead of last July's figure of 3,330,000 units. During the second quarter, the rate dipped about 3 percent from the first quarter's rate.

Despite these modest gains, existing home sales have not hit bottom, according to the NAR forecast. The sales pace is expected to hit 3,189,000-units during next year's second quarter before staging a modest but sustainable recovery. Jitters about the health of the U.S. economy will lead homebuyers to remain cautious throughout the remainder of 1990. As the economy recovers from the mild recession and enjoys lower interest rates, existing home sales are expected to slowly revive. In 1991, sales are expected fall 2.7 percent from 1990. In 1992, sales are projected to grow 3.4 percent.

While the housing market is in a slump, it isn't moribund. Both the Northeast and the South reversed decreases in the sales rate in July by picking up 14.3 percent and 6.9 percent, respectively. The South's 1,400,000-unit annual rate during July was stronger than the region's annual rates in both 1988 and 1989. The Midwest's July rate just matches that of the two previous years. The West, however, was about 16 percent off in July from its 1989 performance.

SINGLE-FAMILY HOME PRICES

(In Dollars)

National Data

	Median		Average	
	Existing	New	Existing	New
Jul 1989	95,200	116,000	121,000	140,300
Feb 1990	95,200	125,200	118,300	150,900
Mar 1990	96,300	119,400	119,500	144,600
Apr 1990	95,600	130,000	117,800	153,400
May 1990	95,600	125,900	118,700	150,700
Jun 1990	97,500	127,000	121,100	152,100
Jul 1990	***98,400***	***121,000***	***121,000***	***150,500***
Annual Averages:				
1988	89,200	113,400	112,500	138,900
1989	92,900	120,400	118,000	148,300
Percent changes in July 1990 since:				
Jul 1989	3.4	4.3	0.0	7.3
Jun 1990	0.9	-4.7	-0.1	-1.1

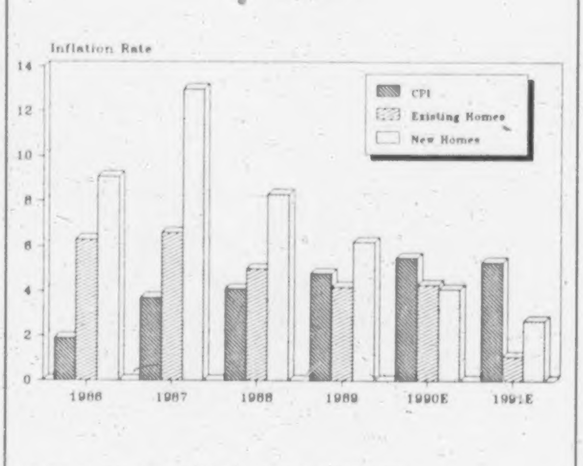
Regional Data

Median Prices for Existing Single-Family Homes

	Northeast	Midwest	South	West
Jul 1989	146,500	73,400	85,800	145,700
Feb 1990	143,400	74,100	85,200	143,300
Mar 1990	148,800	73,500	86,000	141,800
Apr 1990	140,700	75,300	85,900	137,600
May 1990	141,300	73,500	85,100	141,800
Jun 1990	148,300	75,900	87,500	138,100
Jul 1990	***143,300***	***76,300***	***88,900***	***141,500***
Annual Averages:				
1988	142,500	68,200	82,200	124,700
1989	145,100	71,200	84,400	139,800
Percent changes in July 1990 since:				
Jul 1989	-2.2	4.0	3.6	-2.9
Jun 1990	-3.4	0.5	1.6	2.5

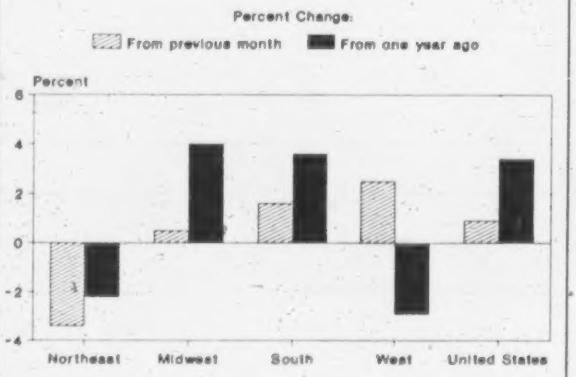
Source: National Association of Realtors
Economics and Research Division

Home Prices



Source: Bureau of Census; E Real Estate Outlook forecast

Home Prices by Region



Source: NAR Economics & Research; Real Estate Outlook forecast

The median prices of existing and new single-family homes took divergent paths in July, with the price for existing homes rising 0.9 percent, or $900, and that for new homes falling 4.7 percent, or $6,000. Both measures have gained ground over the past year, however. The existing home price in July stood at $98,400, 3.4 percent above its July 1989 level. The price for new homes gained 4.3 percent over the period and came in at $121,000 in July. Both increases came during a period of weakness in the housing markets, when prices on individual homes are less likely to be rising. This suggests that the composition of homes being sold is changing -- the ratio of high-priced homes to low-priced homes is rising, forcing the median price up.

The average price for existing homes gained no ground in the past twelve months, returning in July to the $121,000 level it stood at a year ago. The average price of a new home, meanwhile, has risen steeply, gaining $10,200, or 7.3 percent.

The forecast calls for the median price on existing homes to be $96,900 in 1990 and $98,000 in 1991, yielding growth rates for the two years of 4.3 percent and 1.1 percent, respectively.

Robert D. Barr
Director of Forecasting
Forecasting & Policy Analysis Division

AUCTIONS VERSUS PRIVATE SALES OF HOUSES: A DESCRIPTION AND EMPIRICAL ANALYSIS OF THE MELBOURNE, AUSTRALIA MARKET - PART 1

by Kenneth M. Lusht*
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The Pennsylvania State University

INTRODUCTION

In most real estate markets, including those in the United States, a large majority of non-distress sales of residential properties occur as a result of private negotiations. Scotland is an exception, as the use of sealed bids dominates there, as is Australia, notably Melbourne, where the English auction system (open, ascending bids) coexists with private sales. The percentage of residential properties sold at auction in Melbourne has increased during the past decade, and most rapidly between 1983 and 1989. Though statistics on the incidence of marketing systems are not available in aggregate, real estate advertising in newspapers suggests that about 50% of detached houses were listed for sale by auction in Melbourne in 1988, compared to about 25% in 1983. Of those listed for auction in 1988, most were sold that way. The others were sold by private sale either prior to the auction date, or after the auction if the reservation price had not been met.

The incidence of auctions in Melbourne varies among spatial submarkets. Historically, auctions have been favored in the more affluent inner city suburbs, with the highest percentage occurring within six miles of the central business district. However, the percentage of properties listed for sale by auction is also increasing in less affluent submarkets.

The mechanics of an auction sale are straightforward. The listing agreement specifies the date of the auction, which is generally four to five weeks from the listing date, an advertising schedule and associated costs, which the seller pays, the reservation price, which may be changed, and the commission agreement. Commissions on residential properties are based on a sliding percentage of the selling price, but are effectively 2% plus $660. They are the same for auctions and private sales. Between the dates of the listing and the auction, subagents (salespersons) and agents (brokers) perform duties similar to those that would accompany a private sale. The property is advertised, shown to prospective buyers, often by open house, and those individuals potentially most interested are contacted periodically. On some occasions, the agent will entertain offers for a private sale before the auction.

The auction is generally held at the property, and is conducted by an auctioneer paid a fee by the agency for his services, or more commonly by an agent or subagent of the listing firm. The skills required tend to limit those qualified and interested in auctioneering, and there is a measure of status afforded auctioneers within the industry.

If a bid exceeds the seller's reservation price, the property is sold with a 10% deposit and the balance due at settlement, which is typically 60 days from the date of the sale. The sales contracts that result from auctions almost never contain contingency clauses.

The conventional wisdom, widely held among market participants and agents, is that auction sales tend to produce higher prices than do private sales, particularly in active markets and within higher priced submarkets. This proposition has not been empirically tested.

INSTITUTIONAL FRAMEWORK

Melbourne is a city of approximately 3,000,000, located on the Southeast coast of Australia in the state of Victoria. Melbourne is Australia's second largest city, and is composed of 55 local government authorities.

Melbourne's housing is dominated by single-family detached dwellings (76%), with an ownership rate of 73%. There is steady turnover, but perhaps not at a rate as high as in growing American cities of similar size. Approximately 7% of single-family dwellings were sold in 1988, and in 1988, 48% of Melbourne's population over the age of five were not in the same dwelling as they were in 1983.

Residential development has tended to strongly favor the South and East sectors of Melbourne, due in part to geography -- the South and East tend to be cooler, wetter, and have better soil -- and to public transportation facilities that favor the South and East. The most affluent suburbs are in the South and East, and this is where the highest percentage of auction sales occur.

The median price of a house in Melbourne has risen from $37,000 in 1977 to $110,000 in 1988. Percentage increases have been unevenly distributed, ranging from about 100% in the lower price ranges to 300% + in the upper. The larger

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increases have tended to occur in the inner to middle eastern suburbs.

The Agency (Brokerage) Business in Melbourne

The residential agency business in Melbourne operates much the same as in similar sized American cities. Prior to 1956, there was little control of agents' activities. In that year, the Victoria government passed the Estate Agents Act which set commission rates and mandated prelicensing education for agents through courses and seminars delivered by the Real Estate Institute of Victoria (REIV). The REIV is the Australian equivalent of a state association of Realtors® in the United States. Commission rates are set by the State, and are currently based on a sliding scale (as a function of price). Except for properties in the lowest price ranges, the sliding scale converts to 2% of the selling price plus $660. This relatively low commission structure helps explain the fact that in Melbourne there are fewer subagents, agents, and agencies than in American cities of comparable size.

There are currently no educational requirements for subagents, though such legislation is now being considered. Given the lack of the licensing barrier-to-entry, and the relatively low commission scale, agencies are more conservative than their American counterparts so far as hiring practices. As a result, the association between the number of active licensees and activity cycles in the market is not as strong as in the United States.

Training of salespersons is for the most part in-house, or through seminars conducted by state real estate institutes. Auctioneering is learned through Institute seminars and by serving as an apprentice within an agency or agencies.

While there are some differences in the administration of auctions and private sales, the law in Australia is such that there are fewer legal issues than one might imagine. This is because the law with respect to the agent-seller and agent-buyer relationships remains much more closely aligned with the traditional view that the agent represents the seller. This is unlike the United States, where court precedents have moved toward the view that agents have substantial responsibilities to the buyer. The difference is important with respect to auctions, because any information given to the agent by prospective bidders about their degree of interest or the maximum price they may bid can be used to the bidder's detriment at auction.

Reliable data are not available on which to base a comparison of earnings of subagents and agents in Melbourne and similar cities in the United States. Some information is available in the most recent survey conducted by the Real Estate Institute of Australia (Australia's NAR). In 1986, the average total commission generated per subagent ranged from $65,280 in "smaller" agencies to $83,861 in "larger" agencies. These figures include all types of properties and the contributions of agents. Commission agreements between agents and subagents are a matter of private negotiation, but the portion flowing to the subagent tends to be marginally lower in Australia than in the United States. A survey of seventeen Melbourne agents produced a range of 30%-42% of the total commission going to the subagent, with 50% for listing and 50% for selling a common breakdown.

There may also be a further division (again, often 50%-50%) of the listing commission between the lister and the "manager" of the listing. The manager is responsible for duties such as showing the houses and arranging for open houses. Most often the listing subagent also manages.

Compared to the United States, multiple-listing tends to be an unimportant market factor. It is voluntary, is used only for private sales (not auctions), and tends to be a dumping ground for difficult to sell properties. As a result, in reasonably active markets a very small portion of properties are sold by other than the listing agency. The listing agreement between seller and agent also differs as a function of whether it is a listing for sale by auction or for sale privately. Private listings specify sole agency (or in a small percentage of cases, multi-list), and are for 60 days. This time period is legislated. If the property is unsold at the end of 60 days, the sole agency converts to an open listing. If the listing is for multi-list, it lapses. When any listing agreement expires, there is intense competition among firms to sign another listing agreement.

For sale-by-auction listings, legislation requires the auction be held no longer than 45 days from the listing date. If the property is not sold at the auction, the agency retains the sole rights for an additional 30 days, during which time the property is marketed privately. At the end of the 30 day post-auction period, the listing automatically converts to an open listing, unless it is cancelled by the seller. In most cases, the listing is cancelled. Agents and subagents spend their time much as they do in the United States, especially for private listings. Auction listings tend to generate more open houses than do private listings, and require somewhat more paperwork prior to the sale. The sale itself is of course different. The auction is conducted by an auctioneer who is either retained on a fee basis ($100-$200 is a common fee for a house auction) or more commonly, by an agent or subagent of the listing/selling firm. The auction itself is considered part of the service provided by the firm, and the subagent's commission is not affected. Currently there are no legislated requirements to become an auctioneer. In fact, auctioneers need not be licensed agents, though most are.

Some Important Auction Institutions: There are four institutions associated with auction sales in Australia that are thought by market observers to be most important with respect to the incidence and distribution of auctions, their chances of success, the prices brought, and ultimately the profits of agents. These are 1) unconditional contracts, 2) seller bids, 3) reserve prices, and 4) seller-paid advertising.

Unconditional Contracts: Market and Social Issues: A conditional auction sale is a rare exception. While most agents could recall such sales, they clearly represent less than 1% of the total. The main reason is that at auction there must be agreement on the bundle of rights being bought and sold, and this is difficult if there are contingencies specific to individual buyers or the seller. Contingencies, for example for financing, do appear in a significant percentage of private sales contracts in certain Melbourne submarkets. However, in the higher priced markets where auction sales are relatively more popular, contingencies are also rare in private contracts.

With respect to financing, which is the most common (and arguably most important) contingency in the United States, the majority of successful auction bids are made without a formal commitment. There is generally an informal understanding with a lender that a certain percentage of the purchase price will be provided. While unusual, there are cases (agents estimate 1%-3%) when financing cannot be arranged after a successful bid. When that occurs, the 10% deposit becomes a liquidated damage, and the property is typically put back on the market for private sale. The author discussed auction-sale financing with five lenders. All made loans based on the auction price, and all admitted to varying degrees of concern that auction prices may or may not reflect "true" market values. This concern may help explain the socio-economic distribution of auctions, as the willingness of lenders to commit to a loan (formally or informally) based on a to-be-determined auction price may be associated as much with the borrower's financial capacity as with the collateral's value. Thus the loan takes on more of the characteristics of a credit loan than does a loan based on appraised market value. This favors middle to upper income buyers. In addition, middle to lower income buyers are likely less willing to risk the loss of deposit should financing be unobtainable. The risk is not only that a loan may be unobtainable, but also if obtained, the amount may be less than anticipated, and the lower income purchaser is less likely to have the shortfall available.

Finally, though no lender was willing to confirm this, some market observers claim that a major reason lenders are less willing to lend based on auction prices in certain markets is that they perceive a positive association between lower income and the probability of overbidding. In sum, because higher income bidders are more likely to be able to arrange financing, and are in a better position to take the risks associated with bidding without financing in place, there is concern that the auction system systematically excludes certain portions of the population.

Other potentially discriminating elements of auction sales in Melbourne are language difficulties and a lack of information about the mechanics of auctions. The perception that auctions effectively exclude a portion of the public is the major reason the Victoria Ministry of Housing, which provides low interest financing for low income buyers, does not do so for houses purchased at auction.

Seller Bids: Easily the most controversial institution in Australian auction markets is the use of vendor (or seller or "dummy") bids. They are legal and routinely used, and the auctioneer reminds the attendees of this fact just prior to the start of bidding. Seller bids may be made by plants in the crowd or "off the wall" by the auctioneer. Some agents employ "bidders" who follow them from auction to auction. This is usually done by inexperienced auctioneers uncomfortable with simply calling out fictitious bids. Agents claim that while vendor bids are not always used, they are needed in certain circumstances to stimulate the auction process. For example, if there is only a single bidder, there must be a market mechanism which allows that bidder to reach his or her reservation price, which from the seller's perspective will hopefully meet or exceed his or her reserve price.

Those opposed to the use of seller bids make two points. First, if there is only a single legitimate bidder, there is in fact no auction. In such a case, the "proper" marketing mechanism is a privately negotiated price. Second, it is argued that seller bids introduce a deception into the process which can induce a higher bid than would be the case otherwise. It is claimed that this is particularly damaging because in many cases the agent has insight into a bidder's level of interest, and perhaps even knowledge of the maximum price the bidder is willing to pay, and that this can be taken advantage of through seller bids.

The public position of agents is that while vendor bids lubricate the auction process, they do not distort average outcomes. Privately, some will admit that they feel seller bids sometimes produce higher prices than would have been obtained otherwise. It is also true that a percentage of auctions have only a single serious bidder, and that without seller bidding these properties would be "passed in" and later sold privately. If nothing else then, the reported percentage of successful "auctions" is overstated in the sense that some portion of these sales do not result from competitive bidding among prospective buyers.

A final point is that while in most cases there is less incentive to make a seller's bid once the reserve price has been met, there is nothing to prevent such a bid, and according to agents, such bids are occasionally made when there is a feeling it will lead to even higher bids.

While there are strongly held opinions on both sides, there is no empirical evidence as to the pricing effect of seller bids, and it is an institution with characteristics that are not amenable to testing. The legality of such bids, as in Australia, is likely to be a function of political and social pressures rather than economic substance. It is the author's opinion that seller bids can and do affect some prices. It should be pointed out that the use of seller bids is not confined to property markets; other examples are auctions of wine and art.

Reserve Prices: All property auctions in Melbourne are with reserve. The reserve price is not public information, and may be changed at any time prior to and during the auction. It is sometimes the case that the auction will produce more spirited bidding than anticipated, and the original reserve will be raised during the bidding. In effect, an auction with reserve gives the seller the right to reject any and all bids. That sellers use reserve prices seems common sense. Just as it would not be rational to force a seller who is selling privately to accept the highest offer made by a certain date, it does not seem rational for a seller by auction to necessarily accept the highest bid made at the auction. This is particularly true given the vagaries of auction sales, such as the illness of a major prospect(s), the weather, competing auctions, and so on.

Seller-Paid Advertising: As noted earlier, commissions are state-regulated in Australia, and in Melbourne, are effectively 2% of the selling price plus $660. This rate applies to both auctions and private sales.

The author's casual survey of practice in the United States suggests that commissions here are higher for auctions than for private sales. This may reflect the fact that the administration of an auction sale is more time consuming (more paperwork and open houses) than for private sales, and/or that unlike in Australia, brokers in the United States tend to pay advertising costs.

Discussions with Australian agents indicate that they view the institution of seller-paid auction advertising to be an important element in the relative success of auctions. This is not only because the costs are borne by the seller and there is the potential for profiting from advertising discounts, but also because if agents paid for advertising, the expectation is that advertising budgets would decrease, thereby reducing either the probability of successful sales and/or selling prices. Agents also feel the institution of seller-paid advertising sends a signal to the market that the seller is serious.

THE INCIDENCE AND DISTRIBUTION OF AUCTIONS IN MELBOURNE

Data on property transactions are difficult to obtain, particularly with respect to the frequency, geographic distribution, and success rate of auctions. The use of multi-list is limited, and excludes auction listings. Individual agencies are reluctant to share information about auction outcomes, especially those that are unsuccessful. There is also a reluctance by the industry to share aggregate data, as it is felt that the ratio of successful to unsuccessful auctions is a leading indicator of the direction of the market, and this is information they would prefer to keep private. While the reporting system is voluntary, and there is still a bias against reporting unsuccessful auctions, it is the opinion of most observers that the ratio of reported successful to unsuccessful sales, as well as the reported ratios of houses sold at auction to those sold before and after auction, are reliable indicators of the directions of change.

Agencies are also reluctant to divulge ratios of private to auction listings. While agencies often encourage sellers to choose auction marketing, in most submarkets private listings still dominate, and therefore agencies do not dwell on the ratio. There is some evidence that those in the industry tend to overestimate the percentage of auctions; the ratios of newspaper advertisements for private versus auction sales tend to be higher than the ratios quoted by agencies. The advertising ratios are considered the only reasonably reliable data on the frequency and geographic distribution of auctions.

Maher's Studies: The largest and most influential newspaper in Melbourne, the AGE, carries the bulk of real estate advertising, and since 1981, it has printed relatively complete results of each week's auctions as reported by the individual agencies. Professor Chris Maher of Monash University, Melbourne, has completed the only systematic studies of auction frequency, distribution, and success, as well as surveys of housing market participants with respect to their perceptions of the auction system. His work uses the advertising in the AGE as a proxy for marketing type (private versus auction) and the results of auctions reported in the AGE as the measure of auction success. It is partly through his efforts that both the percentage of agencies that report results, and the credibility of those reports, have increased markedly over the past several years.

Explaining the Increased Incidence of Auctions: Perceptions of Market Participants: Maher surveyed the sellers, buyers, and agents of all of the 539 properties listed in the auction results section of the AGE for October 4, 1986. Usable responses were received from 108 of the sellers, 131 of the buyers, and 49 of the agents.

Seller Responses: Sellers were asked, in an open-ended question, why they had chosen to auction their houses. More than one reason was allowed. Table 1 shows the results, tabulated both by the percentage of total responses (Column 1) and by the percentage of respondents who offered a particular reason (Column 2). Three reasons dominate. The advice of the agent is most important, followed by the perception that an auction will achieve the best price, then that an auction reduces the uncertainty about time on the market.

A surprise is the relative lack of importance assigned to the unconditional sales contract. This may reflect the fact that in those areas where auctions dominate, contingencies are uncommon even in contracts for private sales. The estimates of seventeen agents interviewed by the author ranged from a low of less than 1% to a high of 3% of private sales contracts with contingencies. This range has been more or less constant during the past several years. Therefore, the fact that sellers did not list a lack of contingencies as an important factor in choosing auctions as opposed to private sales should not be interpreted as meaning contingencies do not matter. In a separate question which asked the sellers to list the advantages of auctions, the rankings were much the same as those in Table 1. However, the unconditional contract was mentioned by 13.4%.

Sellers were also asked about the disadvantages of auctions. The results are shown in Table 2. The most frequent responses relate to the costs of advertising, the chance of failure, and the stress of an auction. When Maher asked if they would use auctions again, 76% answered affirmatively. Not surprisingly, those whose properties had sold at auction were more positive (92% would use an auction again) than those whose properties had not sold (60%).

When the sellers were asked if they would buy at an auction, 57% answered yes, 20% no, and 23% were unsure. A comparison to the 76% who would sell again by auction seems to strengthen the perception that auctions favor sellers. It must be remembered however, that this sample was not random; it is of individual sellers who originally chose to auction and who did so because they thought it would bring a higher price. Thus, it is not surprising this group would be less enthusiastic on the demand side.

Buyer Responses: Buyers were also asked what they perceived to be the advantages and disadvantages of auctions. Their responses are shown in Tables 3 and 4. Buyers, like sellers, hope for the best. However, Maher noted that even buyers who hoped to get a bargain placed a low probability on that outcome. He asked an additional question of respondents (not shown in Table 3) and found that almost 37% of buyers saw no advantage in buying at auction, and only about 13% thought an auction provided a true market price. It is not surprising therefore, that Table 4 shows that the most frequently mentioned disadvantages are related to the possibility of paying "too much"; one institution associated with perhaps paying too much is the practice of "Dummy (Vendor) Bidding." Finally, a comparison of Tables 2 and 4 shows that buyers and sellers roughly agree on the importance of stress, and that the unconditional contract is mentioned as a disadvantage by buyers with about the same frequency as it is mentioned as an advantage by sellers.

Agent Responses: The number of responses to Maher's survey of agents was relatively low (49 responses), but this is partially explained by the fact that individual agents were involved in more than one transaction.

Tables 5 and 6 show the agents' rankings of auction advantages and disadvantages. The results tend to confirm expectations, and are consistent with the perceptions of the author based on interviews with agents.

Agents value an unconditional contract much more highly than do sellers. This may reflect the fact that the burden of insuring that buyers make good faith efforts to fulfill contingencies tends to fall on the agent.

With respect to the pricing impact of auctions, the responses are difficult to interpret; 41% of the agents said that auctions produce true market prices, while 22% said that auctions produce maximum prices. The problem is that these responses are not necessarily mutually exclusive. If agents subscribe to a definition of market value that references the "highest price" obtainable, there is no difference.

Assuming that the maximum price is considered the true value by most agents, there is consistency among the responses of sellers, buyers, and agents. The percentages who felt auctions produced the highest or maximum price were 39.2%, 47.3%, and 40% respectively, while only a small percentage of sellers and agents thought auctions might produce a lower price. Further, as noted above, though a

TABLE 1
SELLERS: REASONS FOR CHOICE OF AUCTION

	Reason Given	Percent of Responses (%)	Percent of Respondents (%)
1.	On agent's advice	28.5	43.0
2.	Means to achieve best price	19.9	30.0
3.	Quick, definite date	19.2	29.0
4.	Auctions are usual in area	5.3	8.0
5.	Special character of house or location	5.3	8.0
6.	Creates more interest in property	4.6	7.0
7.	Gives fair market value	4.0	6.0
8.	Auction contract is unconditional	3.3	5.0
9.	Offers more than one chance for sale	2.6	4.0
10.	Failed to sell privately	2.6	4.0
11.	Advertising is more effective	2.0	3.0
12.	Other reasons	2.7	4.0

TABLE 2
SELLERS: PERCEIVED DISADVANTAGES OF AUCTIONS

1.	Vendor pays advertising costs	23.1	37.3
2.	Auctions are stressful	19.4	31.3
3.	Risk of auction falling through	11.2	18.1
4.	Pressure from agents	10.4	16.9
5.	Problems on day (e.g., rain)	10.4	16.9
6.	Lack of privacy	9.7	15.7
7.	Strain of presentation	4.5	7.2
8.	Forces seller's hand	3.0	4.8
9.	No disadvantages	2.2	3.6
10.	Other	5.9	9.6

TABLE 3
BUYERS: PERCEIVED ADVANTAGES OF AUCTIONS

1.	Might get a bargain	32.3	37.8
2.	None	31.5	36.9
3.	Sets a true market price	10.8	12.6
4.	Opportunity to gauge interest	7.7	9.0
5.	Certainty of sale	6.2	7.2
6.	Buyer can get upper hand if prepared	4.6	5.4
7.	Opportunity/investment	3.8	4.5
8.	Specific date	3.1	3.6

TABLE 4
BUYERS: PERCEIVED DISADVANTAGES OF AUCTIONS

		Percent of Responses (%)	Percent of Respondents (%)
1.	Competition may force buyer to pay more	26.0	47.3
2.	Dummy bidding	22.1	40.2
3.	Tension/stress	12.3	22.3
4.	Uncertainty of price	12.3	22.3
5.	Pressure may cause mistakes	7.8	14.3
6.	Unconditional contract	7.4	13.4
7.	No cooling off period	5.9	10.7
8.	Timing can rule out bidding	2.9	5.4
9.	Lack of privacy	2.5	4.5
10.	No disadvantages	1.0	1.8

TABLE 5
AGENTS: PERCEIVED ADVANTAGES OF AUCTIONS

1.	Unconditional sale/contract	19.7	55.1
2.	Sets true market price	14.6	40.8
3.	Ensures vendor is genuine	9.5	26.5
4.	Auctions maximize price	8.0	22.4
5.	Creates greater interest/exposure	7.3	20.4
6.	Price undisclosed	6.6	18.4
7.	No cooling off period	6.6	18.4
8.	Pressures buyer to make decision	5.1	14.3
9.	Concentrated, more effective advertising	4.4	12.2
10.	Auctions are quick and decisive	4.4	12.2
11.	Other	14.0	38.7

TABLE 6
AGENTS: PERCEIVED DISADVANTAGES OF AUCTIONS

1.	None	9.7	38.8
2.	Additional costs/advertising	9.4	12.2
3.	Program too long/demanding	7.8	10.2
4.	Excludes buyers unable to bid unconditionally	7.8	10.2
5.	Some sellers set unrealistic reserve	7.8	10.2
6.	Possible failure of auction	6.3	8.2
7.	Not suited to high volume stock	4.7	6.1
8.	Other	25.8	34.4

Source: Chris Maher, "For Whom the Hammer Falls," June 1988; "Information, Intermediation and Sales Strategy in an Urban Housing Market," Summer, 1989; "Attitudes, Outcomes and Implications of Residential Auctions," Monash University, Melbourne, 1989.

relatively high percentage of buyers (38%) hoped to get a bargain, they assigned a low probability to that outcome.

The most striking difference among the responses of agents, sellers and buyers is that almost 39% of agents saw no disadvantages in auctions, compared to 3.6% of sellers and 1.8% of buyers. This reflects both the strong bias of the industry toward auction sales, and the gap between the public position of the real estate industry and the perceptions of buyers and sellers. An additional question asked of agents was how they would improve the auction system. The most frequent response (51.6%) was that the professional standards of auctioning should be elevated. The second most frequent response (19.4%) was that the public needs to be educated about the auction system.

Comments on the Survey Results: The author's personal observations of the market, and what was learned from interviews with agents, suggest that while in general Maher's survey results can be trusted, that is less the case for agents than for sellers and buyers. This is because the public positions of agents may differ from their private positions, particularly with respect to whether auctions produce "true value" or something more.

The most important omission in Table 5, which lists the agents' perceptions of auction advantages, is the fact that auctions are more profitable to agents than are private sales. In private discussions, this emerged as the most important consideration. Not only does the agent on average save the one-quarter percent that is paid by the agent to advertise a private sale, but there is potentially a greater savings through advertising discounts. Based on volume, an individual agency may claim discounts of up to 40% per year. Sellers pay retail while agencies pay wholesale, and the difference can be an end-of-year profit to the agency. (While the consensus of legal opinion is that it is not permissable for the agent to retain the retail-wholesale price difference on an individual transaction, if all advertising is placed through the agent's account, it may be permissable for the agent to claim the difference on an aggregated, annual basis). Given that commissions are 2% + $660, 40% of the average of 1% of the selling price that is spent on auction advertising effectively adds about 15% to the commission.

A second important omission from the list of agents' perceptions of auction advantages is that agents see auctions as a way of "disciplining" unrealistic sellers. An unsuccessful auction sends a message with respect to the seller's reserve price, and a failed auction is a strong incentive for a seller to rethink his or her position. Agents point to this as the main reason that a high percentage of houses that are not sold at auction are sold privately shortly thereafter. Because agents prefer auctions and let that preference be known to sellers, it is not surprising that "disciplining sellers" did not appear as an advantage in a survey for public consumption.

The role of the 1983 Land Sale Act legislation, which in part exempted auction sales from the three-day "cooling-off" period, is commonly thought of as a factor which explains their increased popularity. However, only 5.2% of sellers mentioned this as an advantage of auctions, only 10.7% as a disadvantage by buyers, and only 18.4% as an advantage by agents. This is puzzling, as it is difficult to assign the rather sudden increase in auctions that followed the 1983 legislation to other factors. One possibility is the shifting of the title search burden to the seller through the same legislation. While that was not mentioned as an advantage of auctions in the surveys, it is also true that providing good title is required of the seller regardless of the marketing method.

Another explanation for the post 1983 increase in auctions is that the market became active at about that time, with a concurrent increase in price. This is the type of market environment in which auctions tend to be favored. However, there was little difference in the median priced house sold in Melbourne between January 1983 and January 1988. At that point, the market did become extremely active and prices rose sharply through March of 1989. While the percentage of auctions did jump from January 1988 through March 1989, the continuous increase since 1983 is not explained.

The agents interviewed by the author were of almost unanimous opinion that the 1983 legislation, including both the cooling off period and the placing of the title search burden on the seller, was in fact the catalyst for the increased percentage of auction listings, and that this trend was reinforced by market conditions in the late 1980's.

U.S. Economic Outlook: September 1990

	90.1	90.2	90.3	90.4	91.1	91.2	91.3	91.4	1988	1989	1990	1991	1992
U.S. Economy													
Annual Growth Rate													
Real GNP	1.7	1.2	1.3	-1.4	-1.1	0.0	1.5	2.4	4.5	2.5	1.1	0.0	2.4
Industrial Production	0.6	4.0	1.7	-2.4	-2.6	-1.3	1.9	2.8	5.4	2.6	1.0	-0.5	2.9
Civilian Employment	1.0	0.7	-0.7	-1.1	-0.5	-0.5	0.0	0.5	2.3	2.0	0.6	-0.4	0.8
GNP Inflation Index	4.8	4.7	6.0	4.0	5.3	3.8	3.7	3.6	3.3	4.1	4.4	4.5	3.8
Consumer Prices	8.1	3.7	6.5	7.3	5.4	4.2	4.3	4.1	4.1	4.8	5.5	5.3	4.3
Value of the U.S. Dollar	-16.0	-2.0	-22.6	-7.2	-8.9	-1.4	0.3	1.6	-4.3	6.2	-9.2	-7.0	1.7
Percent													
Mfg. Capacity Utilization	82.6	82.7	82.5	82.2	81.2	80.4	80.2	80.1	83.9	83.9	82.5	80.5	80.2
Civilian Unemployment	5.3	5.3	5.5	5.9	6.2	6.5	6.6	6.7	5.5	5.3	5.5	6.5	6.6
Percent of GNP													
Federal Tax Receipts	20.1	20.2	20.2	20.2	20.2	20.1	20.0	20.0	20.0	20.2	20.2	20.1	20.6
Federal Expenditures	23.2	23.2	22.9	22.9	23.0	23.0	22.9	22.7	22.9	22.8	23.0	22.9	22.3
Federal Budget Deficit	-3.1	-3.0	-2.7	-2.7	-2.8	-2.9	-2.8	-2.6	-2.9	-2.6	-2.9	-2.8	-1.7
Interest Rates, Percent													
Federal Funds Rate	8.3	8.2	8.1	7.7	7.4	7.4	7.4	7.4	7.6	9.2	8.1	7.4	7.4
3-Month T-Bill Rate	7.8	7.7	7.5	7.3	7.0	7.0	7.0	7.0	6.7	8.1	7.6	7.0	7.0
Prime Rate	10.0	10.0	10.0	9.9	9.5	9.3	9.3	9.3	9.3	10.9	10.0	9.3	9.4
Discount Rate	7.0	7.0	7.0	6.7	6.5	6.4	6.3	6.3	6.2	6.9	6.9	6.4	6.3
Corporate AAA Bond Yield	9.2	9.4	9.5	9.3	9.2	9.1	9.0	9.0	9.7	9.3	9.4	9.1	8.9
30-Year Government Bond Yield	8.4	8.7	8.8	8.5	8.4	8.3	8.2	8.2	9.0	8.4	8.6	8.3	8.1
Mortgage Rates, Percent													
30-Year Fixed Rate	10.1	10.3	10.2	10.1	10.1	10.0	9.9	9.8	10.3	10.3	10.2	9.9	9.5
1-Year Adjustable	8.4	8.6	8.4	8.3	8.3	8.3	8.3	8.2	8.5	9.3	8.4	8.3	8.1
Home Sales & Starts													
Thousands													
Total Single-Family Sales (Single-family resales plus 97% of single-family starts)	4,474	4,186	4,132	4,031	4,052	4,030	4,091	4,152	4,648	4,446	4,205	4,081	4,266
Existing Single-Family Sales	3,423	3,319	3,291	3,207	3,214	3,189	3,223	3,257	3,594	3,467	3,310	3,221	3,329
New Single-Family Sales	592	543	535	531	527	524	528	534	676	654	550	528	550
Housing Starts	1,454	1,200	1,159	1,134	1,160	1,171	1,210	1,254	1,491	1,386	1,237	1,199	1,332
Single-Family Units	1,083	893	866	849	864	867	895	923	1,086	1,010	923	887	966
Multi-Family Units	371	307	292	284	296	304	316	332	405	377	314	312	365
2-4 Family Units	43	42	40	39	40	42	43	45	59	55	41	43	50
5+ Family Units	328	265	252	246	255	262	272	286	347	321	273	269	315
Mobile Homes Shipped	196	190	188	177	183	183	188	192	218	199	188	187	199
Percent change -- Year Ago													
Total Single-Family Sales	-2.3	-2.7	-6.3	-10.3	-9.4	-3.7	-1.0	3.0	0.4	-4.3	-5.4	-2.9	4.5
Existing Single-Family Sales	-3.5	-0.6	-4.4	-9.3	-6.1	-3.9	-2.1	1.6	2.4	-3.6	-4.5	-2.7	3.4
New Single-Family Sales	-5.6	-13.7	-22.9	-18.4	-10.8	-3.3	-0.5	2.8	0.8	-3.3	-15.8	-4.0	4.1
Housing Starts	-0.3	-11.4	-13.4	-15.9	-20.2	-2.4	4.5	10.6	-8.6	-7.0	-10.8	-3.0	11.1
Single-Family Units	0.2	-9.9	-12.9	-14.1	-20.2	-2.9	3.3	8.6	-5.9	-7.0	-8.6	-3.9	8.9
Multi-Family Units	-1.6	-15.3	-14.6	-20.9	-20.4	-1.0	8.0	16.6	-14.9	-7.1	-16.7	-0.7	17.3
2-4 Family Units	-2.7	-21.2	-28.6	-27.0	-6.7	-1.0	8.0	16.6	-10.0	-5.7	-25.9	3.8	17.3
5+ Family Units	-1.4	-14.2	-11.9	-19.8	-22.2	-1.0	8.0	16.6	-15.7	-7.3	-15.1	-1.4	17.3
Median Home Prices													
Thousands of Dollars													
Existing Home Prices	95.9	96.2	97.6	97.9	97.4	97.7	98.3	98.7	89.2	92.9	96.9	98.0	100.4
New Home Prices	123.2	127.6	124.6	126.0	126.3	127.8	129.5	131.2	113.4	120.4	125.4	128.7	132.7
Percent Change - Year Ago													
Existing Home Prices	5.2	3.5	2.8	5.6	1.5	1.5	0.7	0.8	5.0	4.2	4.3	1.1	2.4
New Home Prices	4.4	6.8	4.2	1.3	2.5	0.1	3.9	4.1	8.3	6.2	4.1	2.7	3.1

Source: Forecast produced using Laurence H. Meyer & Associates' model of the U.S. economy
Assumptions and simulations by Dr. John Tuccillo and Robert Barr

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

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REAL ESTATE OUTLOOK

Vol. 3, No. 10

October 1990

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- Evidence continues to accumulate that the U.S. economy has fallen into a recession. While the verdict remains in doubt, analysts are becoming less concerned about whether a recession will occur and more concerned with how long and how deep it will be. One prominent sign of weakness was the government's revision in late September of real GNP growth during the second quarter. The growth rate was cut from a slow 1.2 percent to a meager 0.4 percent.
- The current NAR forecast calls for a mild recession beginning in the fourth quarter of 1990. A modest recovery will have begun by the third quarter of 1991. The economy is expected to record a 0.8 percent growth rate for 1990 and show virtually no growth in 1991. With a recovery well under way, the economy will expand 3.0 percent during 1992. These rates compare to a 3.9 percent average for economic growth between 1982 and 1989.
- The housing slump continued in August, as housing starts fell for the eleventh time in the past thirteen months. The annual rate for August was 1,127,000 units, the lowest level since the end of the last recession in October 1982. The figure was 14.9 percent below the August 1989 start rate. Housing starts are expected to reach bottom during the fourth quarter of 1990, when the rate of starts is projected at 1,105,000 units.
- The rate of new homes sold declined 1.4 percent in August and stood at only three-quarters of August 1989's rate. This marks the ninth month in the past year that the sales rate has fallen. Sales of existing homes put together back-to-back monthly sales gains for the first time in almost a year when its July rate grew 3.3 percent.
- While the housing market is in a slump, it isn't moribund. Both the Northeast and the South reversed decreases in the existing homes sales rate in July by picking up 14.3 percent and 6.9 percent, respectively. The South's 1,400,000-unit annual rate during July was stronger than the region's annual rates in both 1988 and 1989. The West, however, was about 16 percent off in July from its 1989 performance.

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Due to a change in our publication deadlines, no new data has been made available for existing home sales or home prices (pages 6 and 7) since the publication of the September *Real Estate Outlook*. August data for these series will appear in the next issue.

I've Fallen . . . . And I Can't Get Up!

by John A. Tuccillo
Chief Economist
and Senior Vice President
Real Estate Finance

This year marks the tenth anniversary of the death of John Lennon; this month marks the 50th anniversary of his birth (as an aside, it also contains the birthday of Groucho Marx and the anniversary of the Bolshevik revolution -- making October the grand month of Marxist-Lennonism). The celebration of these events revolve (no pun intended) around Lennon's song-tribute to peace and anarchy, "Imagine." Were he alive, John could probably field an "Imagine" party ticket next month and win a bunch of Congressional seats. As in, "Imagine we have a budget process," or "Imagine there's no Congress."

The latter takes little imagination because the events of early October resembled nothing so much as the collapse of a parliamentary democracy in Italy or pre-Gaullist France. Only our Constitution and the fact that we speak a version of English masked the fact that we had the kind of government chaos that we used to laugh at regularly some decades ago. Now, politics may be a fun game, but not when it gets in the way of the essential business of governing.

We as a nation need a real cut in the federal budget deficit by a significant amount as soon as possible. The amount in the original budget summit proposal -- $500 billion over five years -- is about the right magnitude. Why do we need the cut? Basically for four reasons:

1. The immense cost of the S&L rescue means that the budget deficit will balloon quite apart from any "normal" deficit spending. Add to this the growing bill for interest on the national debt and automatic increases in entitlement programs because of a growing elderly population, and effectively all wiggle room in the budget disappears. Without a significant change in the course of the budget now, it will spin out of control with disastrous economic consequences.

2. In the long run, we are faced with a challenge of investing in America, in investing in the capital equipment, infrastructure and educational development necessary to maintain our position as a first-rank economic power. That can be done only through increased savings. If we throw away our savings in the sterile pastime of paying for excess government, we will assuredly see our economy sink slowly in the West (and the East).

3. The economy is suffering through a liquidity deprivation that has devastated real estate and is eating away at other key sectors. Reports from around the country confirm the fact that there is virtually no credit available from traditional financing sources for investment real estate. Yet, as long as the federal budget runs deep red, the Fed cannot move to relax its monetary controls and allow credit-dependent industries to expand. The inability to cut the deficit on the part of the public sector is having significantly depressing effects on private enterprise.

4. We are in danger of losing our most dependable source of capital, foreigners. As we spent our way through the lost decade that was the Eighties, we got hooked on foreign funds with no less ferocity than if it were crack. And we paid cheaply for the supply, as long as we were perceived of as the "safe harbor" where political stability could always be assured. The current crisis has cracked that credibility, and sown in the minds of our benefactors the thought that perhaps we will never truly face our own profligacy. Adding to the problem is the plummeting Japanese stock market, causing a withdrawal of Japanese funds from U.S. investment markets.

Each of these reasons focuses on the long-term future of the United States economy. But because of the nature of our system, we define "future" with reference to the political cycle; in part, that's the source of the current budget process mess -- it falls right before a general election. In the minds of our competitors throughout the world, the future means 10, 20 or even 50 years.

The process by which we are to rebuild our industrial capital, restore our roads and bridges, and educate our workers to be skilled in an economy where (as Alvin Toffler puts it) wealth is created by the flow of information will not occur in an instant-gratification, made-for-TV-movie time frame. It takes planning that spans years, not months.

But the need for deficit reduction also concerns our rank as an economic power in a rapidly shrinking world. The Middle East crisis has taken the spotlight from the unification of Europe, an event that will ultimately have a greater impact on our economy than anything Saddam can do. The U.S. is like the New York Yankees -- once untouchable, and now challenged on all sides by peers to rise to their level or drop to a lower league.

The budget mess has set back this process immensely. To the Japanese, who operate in an economy which is centrally directed to long-term goals, the sight of a squabbling Congress and an indecisive president surrounded by bullying aides is like watching some bad remake of *Godzilla*. In short, the reputation of the United States as the "safe harbor" has been weakened. The weakness will be seen in more downward pressure on the value of the dollar, higher interest rates, declining foreign investment, and decreased leverage in trade negotiations. And in the long run, none of these is good for our economic growth.

There's a cable TV cult commercial that fits well here. It's an ad for a portable alert system designed to keep senior citizens and the infirm in touch with potential rescuers. The elderly woman tumbles down the stairs, hits her alert button and utters the soon to be immortal, "I've fallen. . . . and I can't get up!" Let's hope we as a nation can.

Outlook for the Economy and Real Estate

Evidence continues to accumulate that the U.S. economy has fallen into a recession. While the verdict remains in doubt, analysts are becoming less concerned about whether a recession will occur and more concerned with how long and how deep the recession will be. The NAR forecast calls for a relatively mild recession beginning in the fourth quarter of 1990. Growth is projected to return by the end of 1991, and 1992 is expected to be a year of solid recovery and milder inflation rates.

The forecast continues to assume that war does not break out in the Persian Gulf. While spot prices have topped $40 per barrel, the contract price of imported oil is assumed to reach $29 by the second quarter of 1991 before falling back to $26 in 1992. Contract prices in June were about $15.

The Expansion Fizzles Out

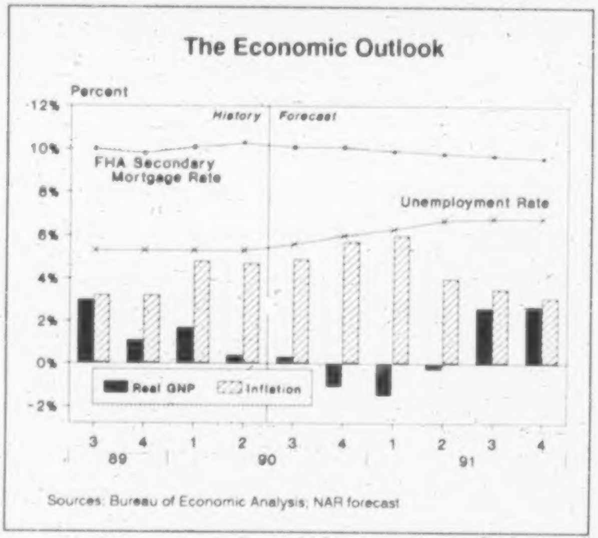
The economic expansion which began in late 1982 appears to be at an end. The annual GNP growth rate in the second quarter of 1990 measured only 0.4 percent, sharply lower than the first quarter's 1.7 percent rate and only a tenth of the expansion's average annual rate. While the NAR forecast calls for only modest 0.3 percent growth in the third quarter, many analysts believe that the reading will fall below zero. The preliminary estimate of growth for the third quarter will be released on October 30 (and revised twice by year end).

The labor markets are showing signs of strain. The unemployment rate has drifted up nearly a half-percentage point to 5.7 percent since June, and payroll employment fell in September for the third consecutive month. Manufacturing payrolls have lost 520,000 workers since early 1989, with almost a quarter of the loss coming in the past two months.

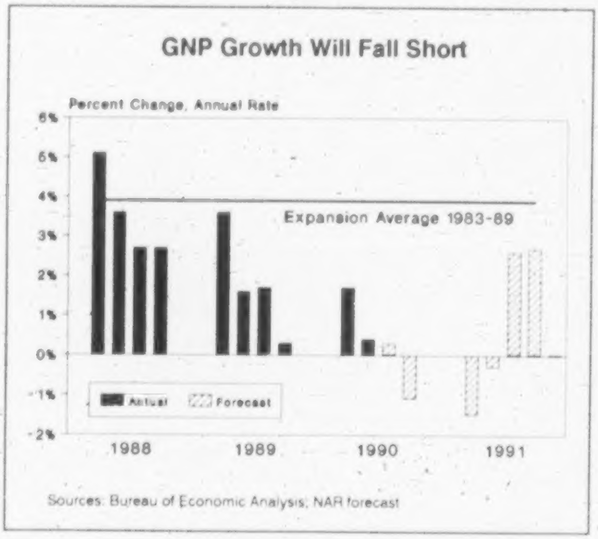
Other signs of economic softness abound. The Conference Board's index of help-wanted advertising fell to its lowest level in six years. The Dow Jones Industrial Average has dropped almost 20 percent since July, as has the broader S&P 500. An index of manufacturing activity maintained by the National Association of Purchasing Managers fell in September to its lowest level in nearly eight years. Another eight-year low was reached by the University of Michigan's consumer confidence poll. And consumer credit through the first eight months of 1990 grew at only a third the monthly rate set in 1988 and 1989.

Bright spots among the gathering gloom include domestic auto sales, which posted a stronger rate in September than the year-to-date monthly average. Also, inventories remain lean. Not only has the inventory-to-sales ratio remained low, but it has remained virtually unchanged over the past few months. Inventories typically rise as a recession hits, and production is consequently slashed as producers sell out of their stocks. The current inventory position suggests that production cutbacks may not play its usual role of sharply aggravating the downturn.

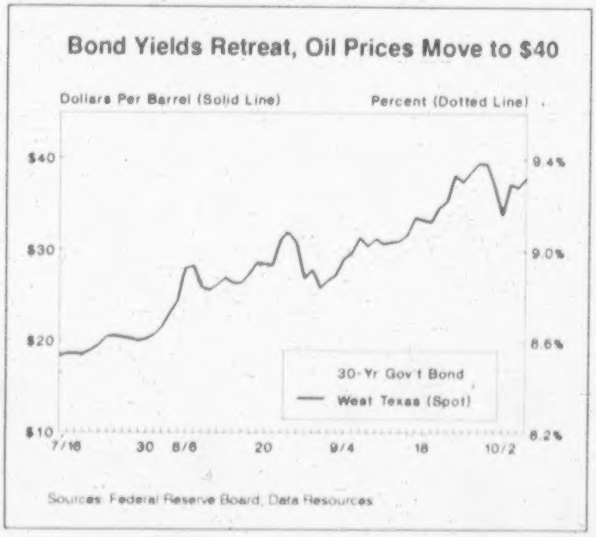
Although it comprises less than 10 percent of the economy, exports may be a source of strength. Factories now export a fifth of their output, and the falling dollar will boost this figure over the coming year. This will be mitigated by slackening demand for U.S. exports as foreign economies slow in the wake of the oil shock.


The Economic Outlook

Sources: Bureau of Economic Analysis; NAR forecast


GNP Growth Will Fall Short

Sources: Bureau of Economic Analysis; NAR forecast


Bond Yields Retreat, Oil Prices Move to $40

Sources: Federal Reserve Board; Data Resources

How Long? How Deep?

Discerning the dimensions of the alleged downturn is tricky. As projected, this recession is shorter and less severe than the typical recession since World War II. The 1990-91 recession is expected to last three quarters while contracting at an average annual rate of 1.0 percent. On average, the seven postwar recessions have a duration of just under a year and have recorded a 2.7 percent annual rate of contraction. But there are many wildcards at play that could prolong the slump, especially the Gulf crisis, the fragility of the banking system, and the government's fiscal and monetary policies..

Another area of concern are balance sheets. Assets such as real estate, Third World loans, and junk bonds have lost value, and as a result many banks, thrifts and corporations have rickety financial structures. Similarily, many homeowners are finding that their houses are worth less than they had previously thought. The fall in the stock market furthers the loss of wealth from the nation's balance sheets. Less confident about new spending and strained by high debt, both consumers and businesses could cut back severely and make the recession deeper.

The Budget Numbers Game

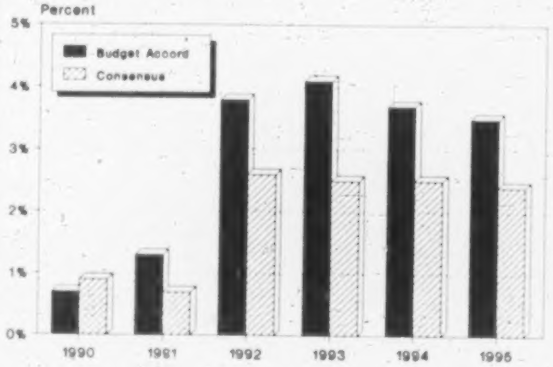
The forecast assumes passage of a five-year budget agreement closely resembling the September 30 budget accord, which was rejected by Congress in early October. If the new deficit-cutting plan uses the same optimistic economic assumptions, however, the projected budget savings will almost certainly fall short. The graph to the right shows the budget negotiators' GNP growth assumptions relative to the consensus forecast, as determined by the 47 forecasters on the panel of the Blue Chip Financial Forecasts. More striking are the differences in interest rate assumptions. The budget accord assumes interest rates will fall sharply, particularly in 1992, so that yields on 10-year Treasury bonds fall below 6 percent. This steep drop in rates is crucial to the budget plan, since more than one-eighth of the projected $500 billion cut in the deficit was due to come from savings on lower interest payments.

Limited Policy Options for the Fed

The inability of the federal government to pass a budget for the fiscal year which started October 1 is contributing to international economic anxiety. The Japanese stock market has tumbled in recent months, and the dollar fell throughout the third quarter, indicating the increasing reluctance of foreign investors to send their funds to the U.S. To keep the capital flow coming to fund our budget deficit, U.S. interest rates need to stay higher than rates overseas, which have been rising. Like the uncertainty over fiscal policy, this ties the hands of Federal Reserve Chairman Alan Greenspan and keeps rates higher than they would be otherwise.

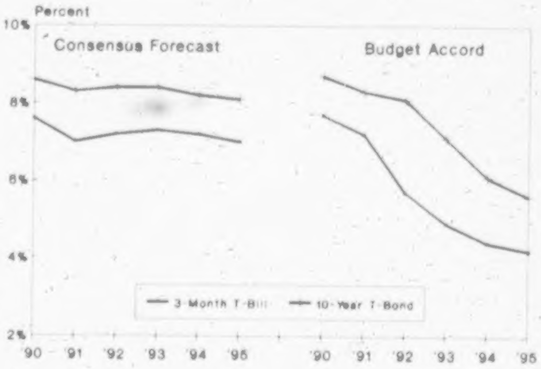
Despite Administration pressure to ease sooner, Greenspan has promised easier monetary policy only after passage of a "credible and sustainable" budget package. The beneficial effects of lower rates may take six months to a year to make a difference in the economy. The Fed is resisting an easier policy for now in fear that it may help fuel inflation and drive the dollar down still further.

A Budget Built on Sand: Real GNP Growth . . .



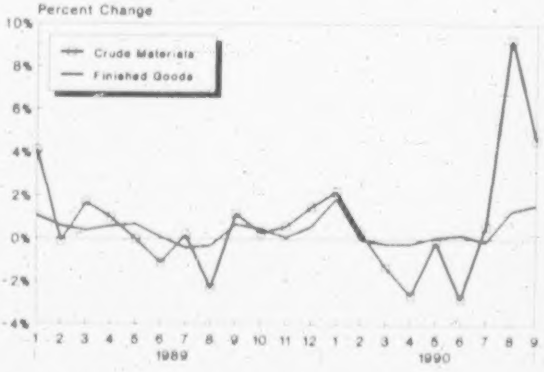
Sources: The Washington Post; Blue Chip Financial Forecasts

. . . And Interest Rates



Sources: The Washington Post; Blue Chip Financial Forecasts

Producer Prices: The First Spike



Source: Bureau of Labor Statistics

Housing Starts

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

	Total	SF	2-4	5+
Aug 1989	1,325	987	54	284
Apr 1990	1,216	898	53	265
May 1990	1,206	897	36	273
Jun 1990	1,189	889	42	258
Jul 1990	1,147	868	30	243
Aug 1990	***1,127***	***840***	***32***	***255***
Annual Averages:				
1988	1,488	1,081	59	348
1989	1,376	1,003	55	318
Percent Changes in August 1990 since:				
Aug 1989	-14.9	-14.9	-40.7	-10.2
Jul 1990	-1.7	-3.2	6.7	2.4

Regional Data

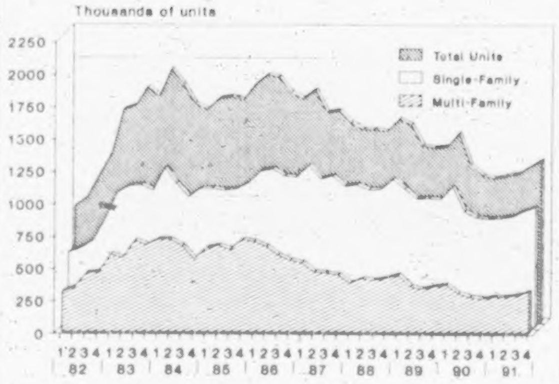
	Northeast	Midwest	South	West
Aug 1989	140	236	559	390
Apr 1990	124	284	469	339
May 1990	127	256	487	336
Jun 1990	113	241	535	300
Jul 1990	110	223	494	320
Aug 1990	***119***	***234***	***441***	***333***
Annual Averages:				
1988	243	274	574	405
1989	184	272	537	396
Percent Changes in August 1990 since:				
Aug 1989	-15.0	-0.8	-21.1	-14.6
Jul 1990	8.2	4.9	-10.7	4.1

Source: Bureau of the Census; Construction Reports, Series C20

The housing slump continued in August, as housing starts fell for the eleventh time in the past thirteen months. The annual rate for August was 1,127,000 units, the lowest level since the end of the last recession in October 1982 and 14.9 percent below the August 1989 figure. The third quarter is now expected to show a 6.3 percent decline from the second quarter.

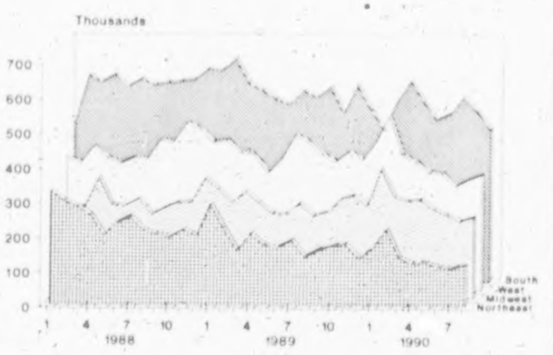
Housing starts are projected to reach bottom in the fourth quarter of 1990 at a 1,105,000 annual rate. Slightly lower interest rates, largely a result of the slumping economy, should give a modest boost to housing starts during 1991. By the fourth quarter of 1991, starts should be at a 1,248,000-unit pace, and economic recovery in 1992 is expected to spur housing starts to 1,305,000 units.

Housing Starts



Source: Bureau of Census; Real Estate Outlook forecast

Housing Starts by Region



Source: Bureau of Census

Multi-family units continue to bear the brunt of the decline in housing starts. In August, multi-family units were started at a 287,000-unit annual rate, 23 percent below 1989's pace. The current NAR forecast calls for multi-families to reach its nadir in the fourth quarter of 1990 with a 267,000-unit rate. This would place multi-families below the low point reached during the last recession.

During August, all four regions remained below their rates for housing starts of one year ago, although the Midwest's decline was by less than one percent. The remaining three regions recorded double-digit declines. Relative to July, three of the four regions posted increases; the South fell by almost 11 percent.

New Home Sales

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

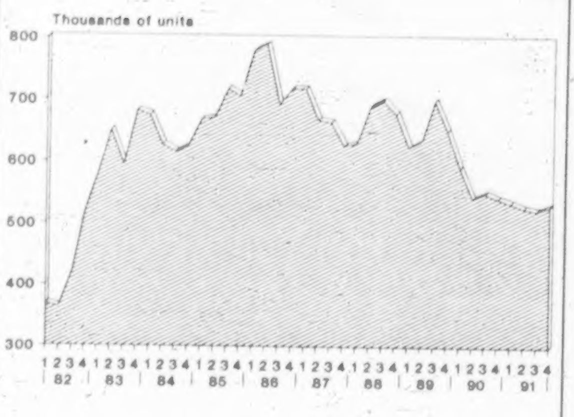
		Mo. Ago % Chg.	Yr. Ago % Chg.
Aug 1989	719	-3.0	1.0
Sep 1989	638	-11.3	-7.7
Oct 1989	636	-0.3	-11.4
Nov 1989	687	8.0	5.7
Dec 1989	633	-7.9	-5.4
Jan 1990	613	-3.2	-12.9
Feb 1990	606	-1.1	-2.7
Mar 1990	558	-7.9	0.4
Apr 1990	533	-4.5	-12.6
May 1990	536	0.6	-17.7
Jun 1990	559	4.3	-13.5
Jul 1990	558	-0.2	-24.7
Aug 1990	**550**	**-1.4**	**-23.5**
Annual Averages:			
1988	676		0.8
1989	654		-3.3

Regional Data

	Northeast	Midwest	South	West
Aug 1989	88	100	294	236
Feb 1990	68	84	265	189
Mar 1990	84	94	221	159
Apr 1990	86	90	209	148
May 1990	71	91	215	159
Jun 1990	83	96	237	143
Jul 1990	77	94	249	138
Aug 1990	**77**	**91**	**244**	**139**
Annual Averages:				
1988	101	98	271	206
1989	90	103	258	202
Percent Changes in August 1990 since:				
Aug 1989	-12.5	-9.0	-17.0	-41.1
Jul 1990	0.0	-3.2	-2.0	0.7

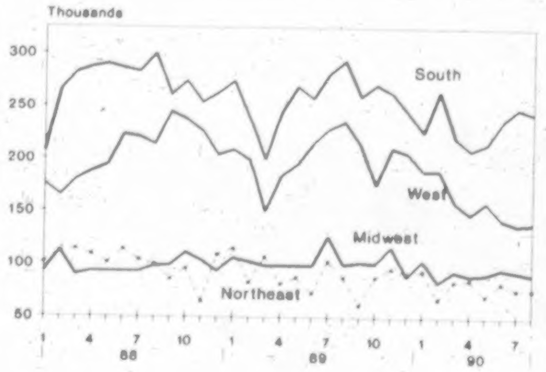
Source: Bureau of the Census, Construction Reports, Series C25

New Home Sales



Source: Bureau of Census; Real Estate Outlook forecast

New Home Sales by Region



Source: Bureau of Census

The rate of new homes sold declined 1.4 percent in August and stood at only three-quarters of the rate of sales in August 1989. This marks the ninth month in the past year that the sales pace has fallen. During the second quarter, new homes were sold at a 543,000-unit annual rate, 8.2 percent below the first quarter's rate.

The 550,000-unit figure for August and a 10,000 unit upward revision to July's figure has led NAR to up its projection of new homes sold during the third quarter to 551,000 units. For the next few quarters, uncertainty about the economy will dampen new home sales activity. The pace is expected to drop to 524,000 units during the third quarter of 1991 before recovering somewhat to 531,000 units in the fourth quarter. The annual figure for 1991 is projected to be 530,000 units, almost 20 percent below the 1989 figure. Although 1992 will be a year of recovery, the annual rate will stand 16 percent below the 1989 figure.

The sales rates in the Midwest and the South both lost ground in August over July, falling 3.2 percent and 2.0 percent, respectively. Meanwhile, the sales rate held even in the Northeast and climbed almost one percent in the West.

Relative to last year's performance, the August sales rate in the West fell 31 percent, by far the furthest drop of the four regions. The Northeast fell by 14 percent, the Midwest by 11 percent, and the South by 5 percent.

Existing Single-Family Home Sales

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

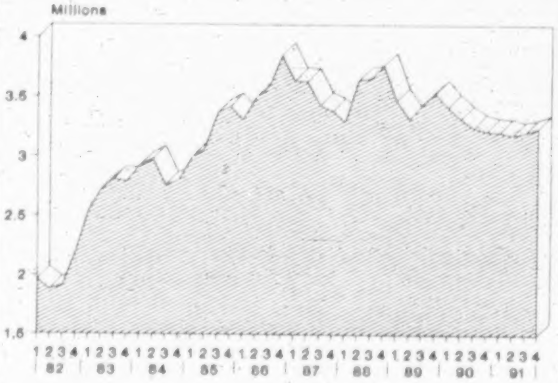
		Mo. Ago % Chg.	Yr. Ago % Chg.
Jul 1989	3,380	1.5	-7.4
Aug 1989	3,440	1.8	-6.8
Sep 1989	3,510	2.0	-3.8
Oct 1989	3,490	-0.6	-5.2
Nov 1989	3,560	2.0	-4.0
Dec 1989	3,560	0.0	-9.2
Jan 1990	3,470	-2.5	-5.2
Feb 1990	3,400	-2.0	-4.2
Mar 1990	3,400	0.0	-0.9
Apr 1990	3,330	-2.1	-3.2
May 1990	3,300	-0.9	1.5
Jun 1990	3,330	0.9	0.0
Jul 1990	***3,440***	***3.3***	***1.8***
Annual Averages:			
1988	3,594		-1.9
1989	3,467		-3.6

Regional Data

	Northeast	Midwest	South	West
Jul 1989	520	940	1310	570
Feb 1990	560	890	1310	650
Mar 1990	500	910	1360	630
Apr 1990	520	920	1300	580
May 1990	520	880	1320	570
Jun 1990	490	960	1310	580
Jul 1990	***560***	***930***	***1400***	***520***
Annual Averages:				
1988	669	929	1348	643
1989	590	931	1320	617
Percent changes in July 1990 since:				
Jul 1989	7.7	-1.1	6.9	-8.8
Jun 1990	14.3	-3.1	6.9	-10.3

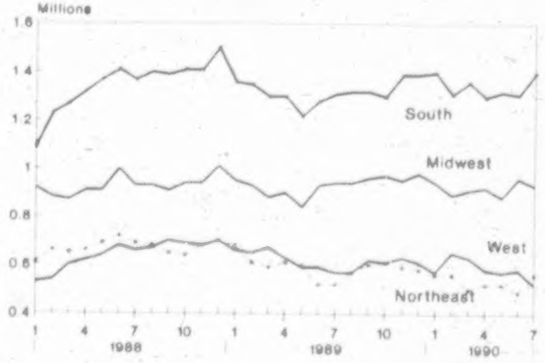
Source: Bureau of the Census, Construction Reports, Series C25

Existing Home Sales



Source: NAR Economics & Research; Real Estate Outlook forecast

Existing Home Sales by Region



Source: NAR Economics & Research

For the first time since September 1989, the sales rate for existing homes posted back-to-back gains in July. The 3.3 percent increase followed June's 0.9 percent gain, leaving July's rate at 3,440,000 units. This placed sales 1.8 percent ahead of last July's figure of 3,330,000 units. During the second quarter, the rate dipped about 3 percent from the first quarter's rate.

Despite these modest gains, existing home sales have not hit bottom, according to the NAR forecast. The sales pace is expected to hit 3,191,000-units during next year's second quarter before staging a modest but sustainable recovery. Jitters about the health of the U.S. economy will lead homebuyers to remain cautious throughout the remainder of 1990. As the economy recovers from the mild recession and enjoys lower interest rates, existing home sales are expected to slowly revive. In 1991, sales are expected fall 2.7 percent from 1990. In 1992, sales are projected to grow 3.2 percent.

While the housing market is in a slump, it isn't moribund. Both the Northeast and the South reversed decreases in the sales rate in July by picking up 14.3 percent and 6.9 percent, respectively. The South's 1,400,000-unit annual rate during July was stronger than the region's annual rates in both 1988 and 1989. The Midwest's July rate just matches that of the two previous years. The West, however, was about 16 percent off in July from its 1989 performance.

Single-Family Home Prices

(In Dollars)

National Data

	Median		Average	
	Existing	New	Existing	New
Jul 1989	95,200	116,000	121,000	140,300
Feb 1990	95,200	125,200	118,300	150,900
Mar 1990	96,300	119,400	119,500	144,600
Apr 1990	95,600	130,000	117,800	153,400
May 1990	95,600	125,000	118,700	150,600
Jun 1990	97,500	125,000	121,100	150,400
Jul 1990	***98,400***	***120,000***	***121,000***	***150,200***
Annual Averages:				
1988	89,200	113,400	112,500	138,900
1989	92,900	120,400	118,000	148,300
Percent changes in July 1990 since:				
Jul 1989	3.4	3.4	0.0	7.1
Jun 1990	0.9	-4.0	-0.1	-0.1

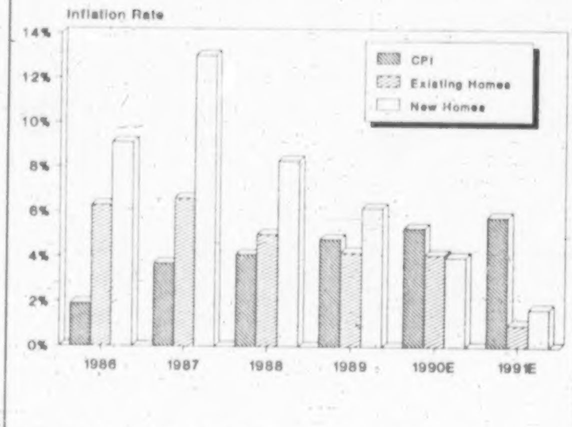
Regional Data

Median Prices for Existing Single-Family Homes

	Northeast	Midwest	South	West
Jul 1989	146,500	73,400	85,800	145,700
Feb 1990	143,400	74,100	85,200	143,300
Mar 1990	148,800	73,500	86,000	141,800
Apr 1990	140,700	75,300	85,900	137,600
May 1990	141,300	73,500	85,100	141,800
Jun 1990	148,300	75,900	87,500	138,100
Jul 1990	***143,300***	***76,300***	***88,900***	***141,500***
Annual Averages:				
1988	142,500	68,200	82,200	124,700
1989	145,100	71,200	84,400	139,800
Percent changes in July 1990 since:				
Jul 1989	-2.2	4.0	3.6	-2.9
Jun 1990	-3.4	0.5	1.6	2.5

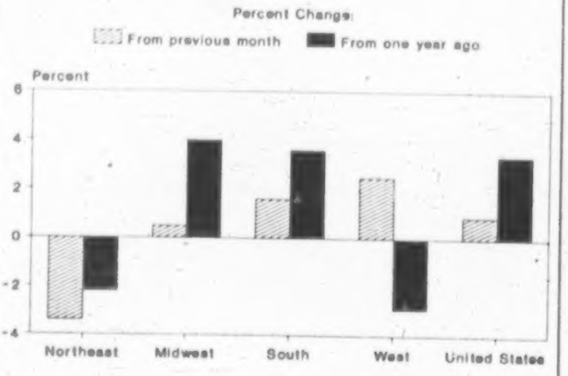
Source: National Association of Realtors
Economics and Research Division

Home Prices



Source: Bureau of Census; E Real Estate Outlook forecast

Home Prices by Region



Source: NAR Economics & Research; Real Estate Outlook forecast

The median prices of existing and new single-family homes took divergent paths in July, with the price for existing homes rising 0.9 percent, or $900, and that for new homes falling 4.0 percent, or $5,000. Both measures have gained an indentical 3.4 percent over the past year, however. The existing home price in July stood at $98,400, and the price for new homes came in at $120,000. Both increases came during a period of weakness in the housing markets, when prices on individual homes are less likely to be rising. This suggests that the composition of homes being sold is changing -- the ratio of high-priced homes to low-priced homes is rising, forcing the median price up.

The average price for existing homes gained no ground in the past twelve months, returning in July to the $121,000 level it stood at a year ago. The average price of a new home, meanwhile, has risen steeply, gaining $9,900, or 7.1 percent.

The forecast calls for the median price on existing homes to be $96,700 in 1990 and $97,700 in 1991, yielding growth rates for the two years of 4.1 percent and 1.0 percent, respectively. The median price on new homes is expected to gain 4.0 percent in 1990 and 1.7 percent in 1991.

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AUCTIONS VERSUS PRIVATE SALES OF HOUSES: A DESCRIPTION AND EMPIRICAL ANALYSIS OF THE MELBOURNE, AUSTRALIA MARKET - PART 2

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PRICE FORMATION AT AUCTIONS AND IN PRIVATE SALES

Auctions

Auctions have a long history. Herodotus reports the use of auctions as early as 500 BC, when men bid for women to marry. Roman emperors Caligula and Aurelius auctioned heirlooms to pay debts. The Romans apparently used the "English" (ascending bid) type of auction, as the word auction is derived from the Latin root auctus (an increase). There are other accounts of auctions in ancient Babylonia, Greece, China, and Japan.

The types of goods sold by auction is long and varied; included are antiques, art, cattle, U.S. Treasury bills, mineral rights, fresh fish, and real property. There are auctions for rare items like diamonds, perishables like fresh fish, and durables like houses. Supply and construction contracts are commonly let by auction.

Auctions may be for a unique unit, as is the case for a painting or a house, for multiple units of a unique product, as is the case for cases of fine wine, or for a package of non-identical items, such as a family of slaves in the 1800's or a group of investment properties today. Auctions are also used to market multiple units of a more or less homogeneous good, such as U.S. Treasury bills and tulip bulbs in the Netherlands.

The diversity of commodities commonly auctioned is such that it is difficult to isolate the characteristics that distinguish them from commodities that tend not to be auctioned. Milgrom (1986) suggests that the only clear differentiation is the " ... need to establish individual prices for each item sold." An example: "Used cars, whose condition varies over a wide range, are sold to dealers by auctions; new cars are not ... Similarly, the price of fresh fish needs to be determined daily, because the supply varies continuously."

The question of why auctions are widely used can also be answered from the perspective of the prices they produce. In general, auctions tend to produce efficient and stable outcomes. This means that over a wide range of assumptions concerning the relative bargaining processes of sellers and buyers, auctions tend to produce the highest possible price; that is, a successful bidder cannot resell at a profit, nor is it likely that there was an interested buyer willing to pay more. However, this does not mean that all auction types will always produce the same price, nor that auctions are always the optimal marketing form.

Auctions Versus Private Sales

The theory with respect to auctions (in general) versus other price-forming mechanisms such as private sales is much less developed than the theory comparing alternative auctions, and the received wisdom tends to be based more on informed speculation than on rigorous analysis.

Milgrom (1989) compares the three general categories of pricing systems: 1) posted, non-negotiable prices as in a grocery store, 2) negotiated prices as in the private sale of houses, and 3) auctions.

Posted prices are used when products are homogeneous and relatively low priced, and when supply will be sufficient to meet the demand. Prices are widely known and easily compared, and as a result buyers and sellers are virtually identical. Because the probability of identifying a buyer willing to pay more is trivial, there is no incentive for a seller (or buyer) to incur the added costs involved in negotiating or auctioning.

Negotiation tends to be used for products that are less standardized and those that tend to have higher unit prices, and when it is relatively costly to

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**This study was funded by a grant from the NATIONAL ASSOCIATION OF REALTORS®*

match supply and demand. Compared to auctions, negotiation tends to be used when there are fewer potential buyers. Milgrom (1986) shows that when there is only a single likely buyer, negotiation is likely to be preferred by the seller, given the criterion of revenue maximization. With more than one buyer however, auction is almost always preferred. Vincent (1988) arrives at a similar conclusion ("few" versus "many" potential buyers) based on the costs to the seller of transmitting private information to potential buyers. Because information costs are borne partly by the seller, when there are fewer potential buyers it may be preferable from a net revenue standpoint to negotiate with one of the buyers than to auction.

Given the wide range of products and circumstances where auctions are commonly used -- from cut flowers in Holland to real estate in Melbourne -- the single characteristic which tends to separate auction and non-auction marketing is that the former is used when prices are uncertain or unstable. In turn, the characteristics most often associated with uncertain or unstable prices are relatively unique or heterogeneous products with high market values. Also, in a market where demand exceeds supply and buyers may be more impatient than sellers, the competitive pressure of the auction process may induce that impatience, leading to maximum expected revenues. In such markets, potential buyers may be concerned about getting "carried away" and overbidding. To minimize that possibility, some potential house buyers in Melbourne hire agents to attend the auctions and do the bidding.

Milgrom (1989) provides a reason why auctions may produce higher revenues in a wide range of situations where the value to the seller is below the value to potential buyers. In such cases, negotiation leads to a price that is the average of the values, while bidding will produce a price that is equal to the second highest bidder's valuation.

Finally, it can be speculated that if buyers have correlated beliefs about value, then an English auction is likely to produce higher revenues than private negotiations. With private negotiation, as in the private sale of a house, the seller's problem is to make an accept/reject decision on each offer as it arrives sequentially. Because the seller does not know the distribution of possible bids, there is a positive probability of accepting too soon.

Empirical Evidence: Auctions Versus Negotiations

Most of the studies that compare prices produced by negotiation versus competitive bidding have involved bond underwritings, with two important results: 1) competitive bidding produces lower costs (higher prices) to bond issuers, and 2) increased competition (more bidders) produces lower costs to bond issuers. A strong positive association between the level of competition and resulting prices was also found; an average price differential of 50% between military contracts let by negotiation compared to competitive bidding.

There also appears to be linkages among prices, the number of bidders, and risk. Riskier (often smaller and less valuable) bond issues tend to attract fewer bidders and thus produce higher costs to issuers.

Sorensen (1979) finds that for lower rated bonds having few bidders ("one or two"), net cost savings are possible using negotiation. Similarly, another study finds the winning bids from auctions with a single bidder to be lower than those from auctions and those with two or three bidders. This result supports the theoretical prediction of Milgrom (1986), and is consistent with the intuition that auctions are increasingly preferred as competition among buyers increases.

There has been no empirical work that tests either the proposition that setting a reserve price increases expected revenues, or that there is an "optimal" reserve price. McAfee and McMillan (1987) refer to indirect evidence that the reserve price should be set above the seller's valuation, and that there should be a commitment to it; that is, in the Netherlands, cut flowers that do not attain the reserve price are destroyed rather than sold at a below-reserve price.

Finally, there is a growing literature that tests the existence of the "winner's curse." Though the results are mixed, the weight of evidence seems to be shifting toward the view that buyers recognize the possibility of overbidding and discount their bids accordingly.

Auctions versus Private Sales: Theory and Evidence, and Behavior in Melbourne Housing Markets

A consensus of the theory and empirical evidence suggests the following conclusions. A profile of those market and product characteristics that favor the use of an auction instead of a posted price or negotiation would include a non-standard good, relatively few units of that good, relatively high values, a relatively high level of competition among buyers, and the ability to provide information to those buyers. Product characteristics aside, negotiation is generally favored when there are relatively few possible buyers and/or the costs of informing those buyers is high.

There appears to be a positive association between the number of bidders and the expected price from an auction, and a positive association between the quality (and value) of the product and the number of bidders. With risk averse bidders, the first price auction produces the highest expected revenue. With affiliated bids, the English auction produces the highest expected revenue.

A commitment to a reserve price increases expected revenue, and if it is not binding (in the sense bidding is allowed to continue even when the reserve price is reached), the English auction is optimal.

There are also less well developed but intuitively appealing arguments that keeping the number of bidders secret is to the seller's advantage, and that with affiliated bids, the ultimate selling price of an item "passed in" (not sold at auction) is adversely affected. However, acknowledging a "passed-in" auction may have the offsetting benefit of confirming the commitment to a minimum price.

These conclusions are strikingly consistent with marketing behavior in Melbourne housing markets. Auctions there tend to be favored for selling high quality, relatively unique properties. Auctions tend to be used most during periods of high demand and rapidly rising prices. When an auction is used to sell a house, the English auction is almost always the choice. When commercial properties are sold by auction (which is almost always), the English auction dominates, but with increasing use of first-price bidding.

Compared to a private sale, preparation for an auction sale generally involves a more intensive and costly effort to increase the number of bidders and, to educate potential bidders. This is done through heavier advertising, and more frequent open houses and individual inspections.

The use of reserve prices is universal, and they are almost always kept secret, likely to encourage greater participation by bidders.

The most controversial of auction practice in Melbourne, the use of seller bids, has not been analyzed, but it can be speculated to have effects generally associated with higher expected prices: Seller bids artificially increase competition, which takes advantage of correlated beliefs and affiliated bids, and conceals the true number of bidders.

AUCTIONS VERSUS PRIVATE NEGOTIATIONS: PRICE DIFFERENCES

The theoretical prediction that pricing mechanisms probably matter has been only weakly supported empirically, and has yet to be tested with respect to English auctions versus private negotiations. This section reports the results of such a test in the Melbourne housing market.

The percentage of houses listed for sale by auction (74%), as well as the percentages of auction listings that sold before auction (12%), at auction (71%), and after auction (17%), are representative of the population of listings and sales in the market area during the study period. There is no statistically significant difference (at the 5% level) in the mean selling prices of any listing-sale pairs.

Data

The sample includes 309 single family detached dwellings that were sold within a market area commonly described as the inner-eastern suburbs of Melbourne from January 1, 1988, through March 31, 1989. The houses were sold through a single agency, and included all of the sales for which complete information could be obtained at reasonable cost. The area from which the sample was drawn is approximately 50 square miles, all within 15 miles of the Central Business

District. It is an upper-middle-income area of high-middle to high-priced houses. The sample included houses that sold from $140,000 to $425,000. The January 1988-March 1989 time period was one of historically high activity in terms of the number of listings and sales, and one in which house prices in Melbourne escalated rapidly, especially in the sample market.

The Empirical Model

The objective was to explain differences in selling prices among houses as a function of how they were listed and sold. Ordinary least squares regression was the statistical model used.

The usual list of physical, functional, and locational variables were included. In addition, as being of either normal or below normal patience, and expected market interest in each property was also as being either normal or below normal

The main variables of interest were how the houses were listed and sold. There were four possible joint outcomes: 1) listed privately, sold privately, 2) listed for auction, sold before auction, 3) listed for auction, sold at auction, and 4) listed for auction, sold after auction. Listed for auction and sold at auction was the default variable.

It is expected that in this market, houses listed and sold at auction will bring higher prices than those listed and sold privately. Expectations with respect to the prices brought by houses listed for auction, but sold before or after the auction are less clear; there is no extant theory and no prior empirical results for guidance. Informed speculation is possible however. First, there is a widely held view among agents in Melbourne that during periods of rapidly escalating prices, it seldom makes sense to sell before an auction, except when a very high price is offered. Specifically, the price must exceed by a significant amount the seller's expectation of the price that will be brought at auction. Given that agents in most cases have extensive information about the intensity of interest in a property, it is reasonable to think that they are able to make accurate judgments about likely prices. This assumption has been found to hold in other auction markets.

The expectation then, is that the prices of houses listed for sale by auction but sold privately before auction will be no lower than, and are likely to be higher than prices brought at auction. The expectation is that houses listed for sale by auction but "passed-in" and sold after auction will bring prices that are no higher than, and are likely to be lower than prices brought at auction. A property that is "passed-in" at auction is generally perceived as a failed effort by the agent, and almost always by the seller who now has "dead-weight" costs of advertising. A failed auction also places buyers in a much stronger bargaining position, particularly if the property's price will be adversely affected by the failure, which is likely if buyer's valuations are affiliated. A failed auction also induces impatience in sellers, and likely in agents, who are in a position to lose the commission unless the property is sold within 30 days of the failed auction. In the sample, all of the houses that were passed-in sold within five weeks of the auction.

Empirical Results

The model performed quite well with most coefficients of plausible size and significant. Of particular interest here, sellers judged to be patient extracted prices that were on average $14,585 higher than the prices extracted by less patient sellers. The difference is significant at the 5% level, and is slightly less than 6% of the mean sale price. Properties expected to generate at least "normal" levels of market interest produced prices that were on average $9,246 higher than the prices produced by properties expected to generate below normal interest. The difference is significant at the 10% level, and is slightly less than 4% of the mean sale price.

The highest prices were brought by auction listings that were sold before auction, followed in order by auction listings sold at auction, auction listings sold after auction, and finally, private listings sold privately. Houses listed for sale by auction and sold either before auction or at auction brought higher prices than houses that sold privately, or that were listed for auction, passed-in, and then sold after the auction. The most important result is that a private listing and sale brought $16,202 less on average than an auction listing and sale at auction, a difference significant at the 1% level. Evaluated at the mean sale price, this is about a 6.5% difference, 5.5% net of the average auction advertising costs of 1%.

Houses listed for sale by auction but sold before auction brought a slight (about 2%) and statistically insignificant premium over houses sold at auction. Houses listed for sale by auction but passed-in and sold after auction brought a lower price (about 4%) than houses sold at auction, but the difference is statistically insignificant.

The results are consistent with the expectation that auction sales would bring higher prices than private sales. However, the results also show that houses listed for auction but sold privately (before or after auction) brought higher prices than houses listed and sold privately. This raises the issue of whether the results are a function of listing effects as well as market and selling effects. Perhaps the heavier advertising and other more intensive marketing efforts that accompany auction listings have price effects regardless of the ultimate selling mechanism.

There is no completely satisfactory way to unbundle the listing and market/selling effects; they do not occur separately in nature. Further, while before or after auction sales are "private," they are clearly influenced by the institutions accompanying an auction listing, and the various market pressures discussed. This is an interesting topic for future inquiry.

At this point, we can speculate that selling effects dominate listing effects. If the opposite were true, we would expect to see most houses in most markets listed for sale by auction. That is not the case.

This leads to a final caveat. These results are from a high-priced submarket during a period of rapidly rising prices. How the outcome would differ under different conditions is not clear.

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Existing Home Sales

Thousands of Units; Percent Change from One Month Ago; Percent Change from One Year Ago

	U.S.			Northeast			Midwest			South			West			
86.01	3,400	-1.2	13.3	730	5.8	28.1	910	-2.2	13.8	1,210	-1.6	9.0	540	-6.9	3.8	86.01
86.02	3,350	-1.5	13.6	680	-6.8	25.9	920	1.1	21.1	1,180	-2.5	4.4	560	3.7	5.7	86.02
86.03	3,270	-2.4	7.9	640	-5.9	12.3	950	3.3	20.3	1,110	-5.9	-2.6	570	1.8	5.6	86.03
86.04	3,580	9.5	18.2	710	10.9	24.6	1,070	12.6	33.8	1,220	9.9	7.0	590	3.5	11.3	86.04
86.05	3,440	-3.9	12.8	690	-2.8	21.1	980	-8.4	19.5	1,200	-1.6	8.1	580	-1.7	5.5	86.05
86.06	3,460	0.6	10.5	670	-2.9	9.8	990	1.0	16.5	1,220	1.7	8.9	580	0.0	5.5	86.06
86.07	3,510	1.4	9.7	680	1.5	7.9	950	-4.0	4.4	1,280	4.9	10.3	600	3.4	17.6	86.07
86.08	3,600	2.6	3.4	690	1.5	4.5	1,000	5.3	5.3	1,280	0.0	0.0	630	5.0	8.6	86.08
86.09	3,670	1.9	7.0	710	2.9	4.4	1,020	2.0	8.5	1,320	3.1	9.1	620	-1.6	3.3	86.09
86.10	3,670	0.0	7.0	720	1.4	4.3	1,000	-2.0	6.4	1,310	-0.8	7.4	650	4.8	10.2	86.10
86.11	3,860	5.2	13.5	710	-1.4	6.0	1,040	4.0	13.0	1,450	10.7	17.9	660	1.5	15.8	86.11
86.12	3,970	2.8	15.4	810	14.1	17.4	1,060	1.9	14.0	1,370	-5.5	11.4	730	10.6	25.9	86.12
87.01	3,580	-9.8	5.3	680	-16.0	-6.8	1,030	-2.8	13.2	1,270	-7.3	5.0	610	-16.4	13.0	87.01
87.02	3,730	4.2	11.3	720	5.9	5.9	1,080	4.9	17.4	1,310	3.1	11.0	620	1.6	10.7	87.02
87.03	3,770	1.1	15.3	740	2.8	15.6	1,120	3.7	17.9	1,320	0.8	18.9	590	-4.8	3.5	87.03
87.04	3,580	-5.0	0.0	680	-8.1	-4.2	1,020	-8.9	-4.7	1,280	-3.0	4.9	600	1.7	1.7	87.04
87.05	3,740	4.5	8.7	720	5.9	4.3	1,000	-2.0	2.0	1,390	8.6	15.8	630	5.0	8.6	87.05
87.06	3,520	-5.9	1.7	690	-4.2	3.0	910	-9.0	-8.1	1,280	-7.9	4.9	640	1.6	10.3	87.06
87.07	3,500	-0.6	-0.3	690	0.0	1.5	930	2.2	-2.1	1,260	-1.6	-1.6	620	-3.1	3.3	87.07
87.08	3,380	-3.4	-6.1	670	-2.9	-2.9	870	-6.5	-13.0	1,260	0.0	-1.6	580	-6.5	-7.9	87.08
87.09	3,400	0.6	-7.4	670	0.0	-5.6	900	3.4	-11.8	1,270	0.8	-3.8	560	-3.4	-9.7	87.09
87.10	3,430	0.9	-6.5	660	-1.5	-8.3	910	1.1	-9.0	1,280	0.8	-2.3	580	3.6	-10.8	87.10
87.11	3,330	-2.9	-13.7	660	0.0	-7.0	890	-2.2	-14.4	1,230	-3.9	-15.2	560	-3.4	-15.2	87.11
87.12	3,240	-2.7	-18.4	640	-3.0	-21.0	860	-3.4	-18.9	1,190	-3.3	-13.1	560	0.0	-23.3	87.12
88.01	3,200	-1.2	-10.6	610	-4.7	-10.3	920	7.0	-10.7	1,090	-8.4	-14.2	530	-5.4	-13.1	88.01
88.02	3,320	3.8	-11.0	660	8.2	-8.3	880	-4.3	-18.5	1,230	12.8	-6.1	540	1.9	-12.9	88.02
88.03	3,382	1.9	-10.3	650	-1.5	-12.2	870	-1.1	-22.3	1,270	3.3	-3.8	600	11.1	1.7	88.03
88.04	3,510	3.8	-2.0	660	1.5	-2.9	910	4.6	-10.8	1,320	3.9	3.1	620	3.3	3.3	88.04
88.05	3,620	3.1	-3.2	690	4.5	-4.2	910	0.0	-9.0	1,370	3.8	-1.4	640	3.2	1.6	88.05
88.06	3,800	5.0	8.0	720	4.3	4.3	1,000	9.9	9.9	1,410	2.9	10.2	680	6.3	6.3	88.06
88.07	3,650	-3.9	4.3	690	-4.2	0.0	930	-7.0	0.0	1,370	-2.8	8.7	660	-2.9	6.5	88.07
88.08	3,690	1.1	9.2	680	-1.4	1.5	930	0.0	6.9	1,400	2.2	11.1	670	1.5	15.5	88.08
88.09	3,650	-1.1	7.4	650	-4.4	-3.0	910	-2.2	1.1	1,390	-0.7	9.4	700	4.5	25.0	88.09
88.10	3,680	0.8	7.3	640	-1.5	-3.0	940	3.3	3.3	1,410	1.4	10.2	690	-1.4	19.0	88.10
88.11	3,710	0.8	11.4	680	6.3	3.0	940	0.0	5.6	1,410	0.0	14.6	680	-1.4	21.4	88.11
88.12	3,920	5.7	21.0	700	2.9	9.4	1,010	7.4	17.4	1,500	6.4	26.1	700	2.9	25.0	88.12
89.01	3,660	-6.6	14.4	680	-2.9	11.5	950	-5.9	3.3	1,360	-9.3	24.8	660	-5.7	24.5	89.01
89.02	3,550	-3.0	6.9	610	-10.3	-7.6	930	-2.1	5.7	1,350	-0.7	9.8	650	-1.5	20.4	89.02
89.03	3,430	-3.4	1.4	590	-3.3	-9.2	880	-5.4	1.1	1,300	-3.7	2.4	670	3.1	11.7	89.03
89.04	3,440	0.3	-2.0	610	3.4	-7.6	900	2.3	-1.1	1,300	0.0	-1.5	630	-6.0	1.6	89.04
89.05	3,250	-5.5	-10.2	600	-1.6	-13.0	840	-6.7	-7.7	1,220	-6.2	-10.9	590	-6.3	-7.8	89.05
89.06	3,330	2.5	-12.4	520	-13.3	-27.8	930	10.7	-7.0	1,280	4.9	-9.2	590	0.0	-13.2	89.06
89.07	3,380	1.5	-7.4	520	0.0	-24.6	940	1.1	1.1	1,310	2.3	-4.4	570	-3.4	-13.6	89.07
89.08	3,440	1.8	-6.8	570	9.6	-16.2	940	0.0	1.1	1,320	0.8	-5.7	570	0.0	-14.9	89.08
89.09	3,510	2.0	-3.8	600	5.3	-7.7	960	2.1	5.5	1,320	0.0	-5.0	620	8.8	-11.4	89.09
89.10	3,490	-0.6	-5.2	610	1.7	-4.7	970	1.0	3.2	1,300	-1.5	-7.8	610	-1.6	-11.6	89.10
89.11	3,560	2.0	-4.0	590	-3.3	-13.2	950	-2.1	1.1	1,390	6.9	-1.4	630	3.3	-7.4	89.11
89.12	3,560	0.0	-9.2	580	-1.7	-17.1	980	3.2	-3.0	1,390	0.0	-7.3	610	-3.2	-12.9	89.12
90.01	3,470	-2.5	-5.2	560	-3.4	-17.6	940	-4.1	-1.1	1,400	0.7	2.9	570	-6.6	-13.6	90.01
90.02	3,400	-2.0	-4.2	560	0.0	-8.2	890	-5.3	-4.3	1,310	-6.4	-3.0	650	14.0	0.0	90.02
90.03	3,400	0.0	-0.9	500	-10.7	-15.3	910	2.2	3.4	1,360	3.8	4.6	630	-3.1	-6.0	90.03
90.04	3,330	-2.1	-3.2	520	4.0	-14.8	920	1.1	2.2	1,300	-4.4	0.0	580	-7.9	-7.9	90.04
90.05	3,300	-0.9	1.5	520	0.0	-13.3	880	-4.3	4.8	1,320	1.5	8.2	570	-1.7	-3.4	90.05
90.06	3,330	0.9	0.0	490	-5.8	-5.8	960	9.1	3.2	1,310	-0.8	2.3	580	1.8	-1.7	90.06
90.07	3,440	3.3	1.8	560	14.3	7.7	930	-3.1	-1.1	1,400	6.9	6.9	520	-10.3	-8.8	90.07

Source: NATIONAL ASSOCIATION OF REALTORS®

Housing Starts

Thousands of Units; Percent Change from One Month Ago; Percent Change from One Year Ago

	Total			Single-Family			2-4 Multi-Family			5+ Multi-Family			
86.01	1972	1.5	15.3	1270	13.1	28.5	100	16.3	-1.0	602	-17.9	-3.2	86.01
86.02	1848	-6.3	13.2	1143	-10.0	6.1	102	2.0	12.1	603	0.2	30.0	86.02
86.03	1876	1.5	4.2	1180	3.2	4.7	79	-22.5	-22.5	617	2.3	8.1	86.03
86.04	1933	3.0	6.2	1197	1.4	8.5	80	1.3	-27.3	656	6.3	7.9	86.04
86.05	1854	-4.1	10.4	1228	2.6	19.6	83	3.8	-21.0	543	-17.2	-0.9	86.05
86.06	1847	-0.4	10.2	1221	-0.6	18.7	76	-8.4	-20.0	550	1.3	-0.4	86.06
86.07	1782	-3.5	5.8	1153	-5.6	6.9	80	5.3	-8.0	549	-0.2	6.0	86.07
86.08	1807	1.4	3.7	1194	3.6	10.8	86	7.5	-9.5	527	-4.0	-7.5	86.08
86.09	1687	-6.6	0.7	1137	-4.8	11.5	64	-25.6	-28.9	486	-7.8	-14.1	86.09
86.10	1681	-0.4	-8.3	1126	-1.0	-2.9	84	31.3	6.3	471	-3.1	-20.8	86.10
86.11	1623	-3.5	-4.4	1113	-1.2	7.0	71	-15.5	-10.1	439	-6.8	-24.2	86.11
86.12	1833	12.9	-5.6	1227	10.2	9.3	111	56.3	29.1	495	12.8	-32.5	86.12
87.01	1774	-3.2	-10.0	1224	-0.2	-3.6	76	-31.5	-24.0	474	-4.2	-21.3	87.01
87.02	1784	0.6	-3.5	1282	4.7	12.2	71	-6.6	-30.4	431	-9.1	-28.5	87.02
87.03	1726	-3.3	-8.0	1205	-6.0	2.1	86	21.1	8.9	435	0.9	-29.5	87.03
87.04	1614	-6.5	-16.5	1181	-2.0	-1.3	62	-27.9	-22.5	371	-14.7	-43.4	87.04
87.05	1628	0.9	-12.2	1141	-3.4	-7.1	68	9.7	-18.1	419	12.9	-22.8	87.05
87.06	1594	-2.1	-13.7	1092	-4.3	-10.6	83	22.1	9.2	419	0.0	-23.8	87.06
87.07	1575	-1.2	-11.6	1137	4.1	-1.4	62	-25.3	-22.5	376	-10.3	-31.5	87.07
87.08	1605	1.9	-11.2	1120	-1.5	-6.2	59	-4.8	-31.4	426	13.3	-19.2	87.08
87.09	1695	5.6	0.5	1232	10.0	8.4	49	-16.9	-23.4	414	-2.8	-14.8	87.09
87.10	1515	-10.6	-9.9	1090	-11.5	-3.2	64	30.6	-23.8	361	-12.8	-23.4	87.10
87.11	1656	9.3	2.0	1112	2.0	-0.1	52	-18.8	-26.8	492	36.3	12.1	87.11
87.12	1400	-15.5	-23.6	1034	-7.0	-15.7	51	-1.9	-54.1	315	-36.0	-36.4	87.12
88.01	1339	-4.4	-24.5	986	-4.6	-19.4	51	0.0	-32.9	302	-4.1	-36.3	88.01
88.02	1507	12.5	15.5	1101	11.7	-14.1	57	11.8	-19.7	349	15.6	-19.0	88.02
88.03	1541	2.3	-10.7	1188	7.9	-1.4	59	3.5	-31.4	294	-15.8	-32.4	88.03
88.04	1570	1.9	-2.7	1070	-9.9	-9.4	57	-3.4	-8.1	443	50.7	19.4	88.04
88.05	1414	-9.9	-13.1	1011	-5.5	-11.4	54	-5.3	-20.6	349	-21.2	-16.7	88.05
88.06	1476	4.4	-7.4	1100	8.8	0.7	63	16.7	-24.1	313	-10.3	-25.3	88.06
88.07	1460	-1.1	-7.3	1056	-4.0	-7.1	51	-19.0	-17.7	353	12.8	-6.1	88.07
88.08	1480	1.4	-7.8	1088	3.0	-2.9	60	17.6	1.7	332	-5.9	-22.1	88.08
88.09	1475	-0.3	-13.0	1046	-3.9	-15.1	64	6.7	30.6	365	9.9	-11.8	88.09
88.10	1511	2.4	-0.3	1128	7.8	3.5	58	-9.4	-9.4	325	-11.0	-10.0	88.10
88.11	1556	3.0	-6.0	1125	-0.3	1.2	69	19.0	32.7	362	11.4	-26.4	88.11
88.12	1564	0.5	11.7	1131	0.5	9.4	62	-10.1	21.6	371	2.5	17.8	88.12
89.01	1659	6.1	23.9	1188	5.0	20.5	66	6.5	29.4	405	9.2	34.1	89.01
89.02	1454	-12.4	-3.5	1026	-13.6	-6.8	60	-9.1	5.3	368	-9.1	5.4	89.02
89.03	1405	-3.4	-8.8	979	-4.6	-17.6	51	-15.0	-13.6	375	1.9	27.6	89.03
89.04	1341	-4.6	-14.6	1028	5.0	-3.9	62	21.6	8.8	251	-33.1	-43.3	89.04
89.05	1308	-2.5	-7.5	977	-5.0	-3.4	43	-30.6	-20.4	288	14.7	-17.5	89.05
89.06	1414	8.1	-4.2	971	-0.6	-11.7	55	27.9	-12.7	388	34.7	24.0	89.06
89.07	1424	0.7	-2.5	1029	6.0	-2.6	58	5.5	13.7	337	-13.1	-4.5	89.07
89.08	1325	-7.0	-10.5	987	-4.1	-9.3	54	-6.9	-10.0	284	-15.7	-14.5	89.08
89.09	1263	-4.7	-14.4	969	-1.8	-7.4	56	3.7	-12.5	238	-16.2	-34.8	89.09
89.10	1423	12.7	-5.8	1023	5.6	-9.3	60	7.1	3.4	340	42.9	4.6	89.10
89.11	1347	-5.3	-13.4	1010	-1.3	-10.2	47	-21.7	-31.9	290	-14.7	-19.9	89.11
89.12	1273	-5.5	-18.6	931	-7.8	-17.7	53	12.8	-14.5	289	-0.3	-22.1	89.12
90.01	1568	23.2	-5.5	1099	18.0	-7.5	53	0.0	-19.7	416	43.9	2.7	90.01
90.02	1488	-5.1	2.3	1154	5.0	12.5	42	-20.8	-30.0	292	-29.8	-20.7	90.02
90.03	1307	-12.2	-7.0	996	-13.7	1.7	35	-16.7	-31.4	276	-5.5	-26.4	90.03
90.04	1216	-7.0	-9.3	898	-9.8	-12.6	53	51.4	-14.5	265	-4.0	5.6	90.04
90.05	1206	-0.8	-7.8	897	-0.1	-8.2	36	-32.1	-16.3	273	3.0	-5.2	90.05
90.06	1189	-1.4	-15.9	889	-0.9	-8.4	42	16.7	-23.6	258	-5.5	-33.5	90.06
90.07	1147	-3.5	-19.5	868	-2.4	-15.6	30	-28.6	-48.3	249	-3.5	-26.1	90.07
90.08	1127	-1.7	-14.9	840	-3.2	-14.9	32	6.7	-40.7	255	2.4	-10.2	90.08

Source: Bureau of Census

Housing Starts

Thousands of Units; Percent Change from One Month Ago; Percent Change from One Year Ago

	Northeast			Midwest			South			West			
86.01	322	13.4	47.7	286	4.0	21.2	898	0.3	18.2	466	-4.5	-6.2	86.01
86.02	338	5.0	50.2	280	-2.1	78.3	747	-16.8	-4.1	483	3.6	2.5	86.02
86.03	285	-15.7	18.8	316	12.9	15.3	782	4.7	-5.9	493	2.1	8.4	86.03
86.04	310	8.8	13.6	349	10.4	47.3	761	-2.7	-7.3	513	4.1	4.7	86.04
86.05	274	-11.6	15.1	252	-27.8	-0.8	799	5.0	7.8	529	3.1	18.3	86.05
86.06	286	4.4	5.9	294	16.7	24.1	768	-3.9	4.6	499	-5.7	14.7	86.06
86.07	272	-4.9	25.3	325	10.5	47.1	712	-7.3	-9.4	473	-5.2	2.8	86.07
86.08	330	21.3	44.1	311	-4.3	23.4	708	-0.6	-6.6	458	-3.2	-9.1	86.08
86.09	295	-10.6	20.9	269	-13.5	15.0	698	-1.4	-3.1	425	-7.2	-11.1	86.09
86.10	281	-4.7	-11.1	263	-2.2	3.5	683	-2.1	-14.9	454	6.8	-1.5	86.10
86.11	271	-3.6	13.4	271	3.0	26.0	610	-10.7	-23.0	471	3.7	4.2	86.11
86.12	312	15.1	9.9	365	34.7	32.7	615	0.8	-31.3	541	14.9	10.9	86.12
87.01	302	-3.2	-6.2	423	15.9	47.9	609	-1.0	-32.2	440	-18.7	-5.6	87.01
87.02	262	-13.2	-22.5	360	-14.9	28.6	661	8.5	-11.5	501	13.9	3.7	87.02
87.03	292	11.5	2.5	333	-7.5	5.4	628	-5.0	-19.7	473	-5.6	-4.1	87.03
87.04	258	-11.6	-16.8	290	-12.9	-16.9	662	5.4	-13.0	404	-14.6	-21.2	87.04
87.05	302	17.1	10.2	306	5.5	21.4	629	-5.0	-21.3	391	-3.2	-26.1	87.05
87.06	259	-14.2	-9.4	293	-4.2	-0.3	602	-4.3	-21.6	440	12.5	-11.8	87.06
87.07	267	3.1	-1.8	244	-16.7	-24.9	636	5.6	-10.7	428	-2.7	-9.5	87.07
87.08	264	-1.1	-20.0	290	18.9	-6.8	632	-0.6	-10.7	419	-2.1	-8.5	87.08
87.09	263	-0.4	-10.8	310	6.9	15.2	706	11.7	1.1	416	-0.7	-2.1	87.09
87.10	264	0.4	-6.0	248	-20.0	-5.7	612	-13.3	-10.4	391	-6.0	-13.9	87.10
87.11	263	-0.4	-3.0	333	34.3	22.9	639	4.4	4.8	421	7.7	-10.6	87.11
87.12	234	-11.0	-25.0	269	-19.2	-26.3	577	-9.7	-6.2	320	-24.0	-40.9	87.12
88.01	292	24.8	-3.3	212	-21.2	-49.9	459	-20.5	-24.6	376	17.5	-14.5	88.01
88.02	290	-0.7	10.7	258	21.7	-28.3	592	29.0	-10.4	367	-2.4	-26.7	88.02
88.03	292	0.7	0.0	251	-2.7	-24.6	580	-2.0	-7.6	418	13.9	-11.6	88.03
88.04	252	-13.7	-2.3	337	34.3	16.2	598	3.1	-9.7	383	-8.4	-5.2	88.04
88.05	205	-18.7	-32.1	274	-18.7	-10.5	565	-5.5	-10.2	370	-3.4	-5.4	88.05
88.06	244	19.0	-5.8	268	-2.2	-8.5	584	3.4	-3.0	380	2.7	-13.6	88.06
88.07	249	2.0	-6.7	277	3.4	13.5	566	-3.1	-11.0	368	-3.2	-14.0	88.07
88.08	227	-8.8	-14.0	249	-10.1	-14.1	569	0.5	-10.0	435	18.2	3.8	88.08
88.09	209	-7.9	-20.5	262	5.2	-15.5	581	2.1	-17.7	423	-2.8	1.7	88.09
88.10	197	-5.7	-25.4	268	2.3	8.1	578	-0.5	-5.6	468	10.6	19.7	88.10
88.11	216	9.6	-17.9	270	0.7	-18.9	609	5.4	-4.7	461	-1.5	9.5	88.11
88.12	209	-3.2	-10.7	346	28.1	28.6	607	-0.3	5.2	402	-12.8	25.6	88.12
89.01	288	37.8	-1.4	304	-12.1	43.4	639	5.3	39.2	428	6.5	13.8	89.01
89.02	219	-24.0	-24.5	267	-12.2	3.5	571	-10.6	-3.5	397	-7.2	8.2	89.02
89.03	163	-25.6	-44.2	301	12.7	19.9	547	-4.2	-5.7	394	-0.8	-5.7	89.03
89.04	205	25.8	-18.7	272	-9.6	-19.3	529	-3.3	-11.5	335	-15.0	-12.5	89.04
89.05	174	-15.1	-15.1	243	-10.7	-11.3	515	-2.6	-8.8	376	12.2	1.6	89.05
89.06	168	-3.4	-31.1	242	-0.4	-9.7	553	7.4	-5.3	451	19.9	18.7	89.06
89.07	190	13.1	-23.7	276	14.0	-0.4	531	-4.0	-6.2	427	-5.3	16.0	89.07
89.08	140	-26.3	-38.3	236	-14.5	-5.2	559	5.3	-1.8	390	-8.7	-10.3	89.08
89.09	160	14.3	-23.4	247	4.7	-5.7	486	-13.1	-16.4	370	-5.1	-12.5	89.09
89.10	174	8.8	-11.7	285	15.4	6.3	567	16.7	-1.9	397	7.3	-15.2	89.10
89.11	179	2.9	-17.1	296	3.9	9.6	498	-12.2	-18.2	374	-5.8	-18.9	89.11
89.12	138	-22.9	-34.0	267	-9.8	-22.8	440	-11.6	-27.5	428	14.4	6.5	89.12
90.01	168	21.7	-41.7	373	39.7	22.7	526	19.5	-17.7	501	17.1	17.1	90.01
90.02	224	33.3	2.3	293	-21.4	9.7	581	10.5	1.8	390	-22.2	-1.8	90.02
90.03	139	-37.9	-14.7	280	-4.4	-7.0	520	-10.5	-4.9	368	-5.6	-6.6	90.03
90.04	124	-10.8	-39.5	284	1.4	4.4	469	-9.8	-11.3	339	-7.9	1.2	90.04
90.05	127	2.4	-27.0	256	-9.9	5.3	487	3.8	-5.4	336	-0.9	-10.6	90.05
90.06	113	-11.0	-32.7	241	-5.9	-0.4	535	9.9	-3.3	300	-10.7	-33.5	90.06
90.07	110	-2.7	-42.1	223	-7.5	-19.2	494	-7.7	-7.0	320	6.7	-25.1	90.07
90.08	119	8.2	-15.0	234	4.9	-0.8	441	-10.7	-21.1	333	4.1	-14.6	90.08

Source: Bureau of Census

U.S. Economic Outlook: October 1990

Quarterly figures are seasonally adjusted annual rates

	90.1	90.2	90.3	90.4	91.1	91.2	91.3	91.4	1988	1989	1990	1991	1992
U.S. Economy													
Annual Growth Rate													
Real GNP	1.7	0.4	0.3	-1.1	-1.5	-0.3	2.6	2.7	4.5	2.5	0.8	-0.1	3.0
Industrial Production	0.6	4.1	1.7	-3.7	-4.4	-2.2	3.2	3.7	5.4	2.6	0.9	-1.2	3.6
Civilian Employment	1.0	0.7	-2.0	-0.8	-0.8	-0.7	0.1	0.7	2.3	2.0	0.5	-0.6	1.0
GNP Inflation Index	4.8	4.7	4.9	5.7	6.0	4.0	3.5	3.1	3.3	4.1	4.4	4.9	3.2
Consumer Prices	8.1	3.7	5.4	7.5	7.4	4.6	4.1	3.5	4.1	4.8	5.3	5.8	3.6
Value of the U.S. Dollar	-16.0	-2.0	-21.7	-13.1	-8.2	-3.8	2.3	2.1	-4.3	6.2	-9.4	-8.0	2.6
Percent													
Mfg. Capacity Utilization	82.6	82.7	82.5	82.0	80.7	79.8	79.8	79.8	83.9	83.9	82.5	80.0	80.2
Civilian Unemployment	5.3	5.3	5.6	6.0	6.3	6.7	6.8	6.8	5.5	5.3	5.5	6.7	6.5
Percent of GNP													
Federal Tax Receipts	20.1	20.3	20.1	20.4	20.5	20.4	20.4	20.4	20.0	20.2	20.2	20.4	20.6
Federal Expenditures	23.2	23.4	23.1	23.2	23.2	23.2	23.1	22.9	22.9	22.8	23.2	23.1	22.7
Federal Budget Deficit	-3.1	-3.0	-3.0	-2.8	-2.7	-2.9	-2.7	-2.5	-2.9	-2.6	-3.0	-2.7	-2.1
Interest Rates, Percent													
Federal Funds Rate	8.3	8.2	8.1	7.8	7.6	7.4	7.5	7.5	7.6	9.2	8.1	7.5	7.6
3-Month T-Bill Rate	7.8	7.7	7.4	7.3	7.2	7.0	7.1	7.0	6.7	8.1	7.6	7.1	7.1
Prime Rate	10.0	10.0	10.0	9.7	9.5	9.5	9.5	9.5	9.3	10.9	9.9	9.5	9.5
Discount Rate	7.0	7.0	7.0	7.0	6.9	6.8	6.8	6.8	6.2	6.9	7.0	6.8	6.8
Corporate AAA Bond Yield	9.2	9.4	9.4	9.4	9.2	9.1	9.0	8.9	9.7	9.3	9.3	9.1	8.8
30-Year Government Bond Yield	8.4	8.7	8.8	8.8	8.6	8.5	8.4	8.3	9.0	8.4	8.7	8.4	8.2
Mortgage Rates, Percent													
30-Year Fixed Rate	10.1	10.3	10.1	10.1	9.9	9.8	9.7	9.6	10.3	10.3	10.2	9.8	9.5
1-Year Adjustable	8.4	8.6	8.4	8.3	8.3	8.3	8.2	8.2	8.5	9.3	8.4	8.3	8.0
Home Sales & Starts													
Thousands													
Total Single-Family Sales (Single-family resales plus 97% of single-family starts)	4,474	4,195	4,076	4,036	4,033	4,021	4,083	4,150	4,648	4,446	4,195	4,072	4,237
Existing Single-Family Sales	3,423	3,327	3,253	3,223	3,215	3,191	3,213	3,250	3,594	3,467	3,307	3,217	3,319
New Single-Family Sales	592	543	551	543	536	528	524	531	676	654	557	530	550
Housing Starts	1,454	1,204	1,128	1,105	1,125	1,137	1,192	1,248	1,491	1,386	1,223	1,175	1,305
Single-Family Units	1,083	895	848	838	844	855	897	928	1,086	1,010	916	881	946
Multi-Family Units	371	309	280	267	281	282	295	320	405	377	307	294	358
2-4 Family Units	43	44	40	38	40	40	42	45	59	55	41	42	51
5+ Family Units	328	265	240	230	241	242	254	275	347	321	266	253	308
Mobile Homes Shipped	196	190	180	181	182	183	188	194	218	199	187	187	198
Percent change – Year Ago													
Total Single-Family Sales	-2.3	-2.5	-7.5	-10.2	-9.8	-4.1	0.2	2.8	0.4	-4.3	-5.6	-2.9	4.1
Existing Single-Family Sales	-3.5	-0.4	-5.5	-8.9	-6.1	-4.1	-1.3	0.8	2.4	-3.6	-4.6	-2.7	3.2
New Single-Family Sales	-5.6	-13.7	-22.9	-18.4	-10.8	-3.3	-0.5	2.8	0.8	-3.3	-14.7	-5.0	3.8
Housing Starts	-0.3	-11.1	-15.6	-18.0	-22.7	-5.6	5.7	12.9	-8.6	-7.0	-11.8	-3.9	11.0
Single-Family Units	0.2	-9.8	-14.7	-15.2	-22.1	-4.4	5.7	10.7	-5.9	-7.0	-9.3	-3.8	7.4
Multi-Family Units	-1.6	-14.7	-18.2	-25.7	-24.4	-8.9	5.5	19.8	-14.9	-7.1	-18.5	-4.0	21.7
2-4 Family Units	-2.7	-18.1	-29.3	-29.2	-8.4	-8.8	5.5	19.8	-10.0	-5.7	-25.9	1.3	21.7
5+ Family Units	-1.4	-14.1	-16.0	-25.1	-26.5	-8.9	5.5	19.8	-15.7	-7.3	-17.2	-4.9	21.7
Median Home Prices													
Thousands of Dollars													
Existing Home Prices	95.9	96.2	97.4	97.4	97.2	97.3	97.9	98.5	89.2	92.9	96.7	97.7	100.3
New Home Prices	123.2	127.6	124.4	125.5	125.7	126.4	127.8	129.2	113.4	120.4	125.2	127.3	131.0
Percent Change - Year Ago													
Existing Home Prices	5.2	3.5	2.6	5.1	1.3	1.1	0.5	1.1	5.0	4.2	4.1	1.0	2.6
New Home Prices	4.4	6.8	4.0	0.9	2.0	-1.0	2.7	2.9	8.3	6.2	4.0	1.7	2.9

Source: Forecast produced using Laurence H. Moyer & Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo and Robert Barr.

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